Supreme Court, U. S.
FILED
OCT 12 1979
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE
SUPREME COURT OF THE STATE OF UTAH

ROBERT H. BORK
142 Huntington Street
New Haven, Connecticut 06511

CALVIN L. RAMPTON
800 Walker Bank Building
Salt Lake City, Utah 84111

Counsel for Wexpro Company

ROBERT S. CAMPBELL, JR.
310 South Main Street,
12th Floor
Salt Lake City, Utah 84101

REX E. LEE
2840 Iroquois Drive
Provo, Utah 84601

Counsel for Mountain Fuel Supply Company

EDWARD W. CLYDE
351 South State Street
Salt Lake City, Utah 84111

Counsel for Stockholders

TABLE OF CONTENTS

Page

OPINION BELOW 2

JURISDICTION 2

QUESTIONS PRESENTED 2

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 3

STATEMENT OF THE CASE 3

1. *The Nature of the Dispute* 3
2. *Origin and Functions of Mountain Fuel* 6
3. *The Exploration and Development Program* 7
4. *Ratepayer Benefits from the Program* 8
5. *The Ratepayer Risk Issue* 9
6. *Interstate Commerce* 10
7. *Investor Reliance* 11
8. *Formation and Transfer to Wexpro* 11
9. *Position of Respondents* 12
10. *Utilities Commission Holding* 12
11. *Utah Supreme Court Holding* 13
12. *Termination of Mountain Fuel Exploration and Development* 15

REASONS FOR GRANTING THE WRIT 15

I. UTAH'S EXTRATERRITORIAL REGULATION IS AN IMPERMISSIBLE INTERFERENCE WITH AND BURDEN UPON INTERSTATE COMMERCE ..18

Page

II. UTAH'S REGULATION IS PREEMPTED BY FEDERAL REGULATION OF OIL AND NATURAL GAS SALES 23

A General Framework of Preemptive Federal Oil and Natural Gas Regulation 23

B. Federal Preemption of Natural Gas 25

C. Federal Preemption of Oil 26

III. UTAH HAS UNCONSTITUTIONALLY CONFISCATED PETITIONERS' OIL PROPERTIES WITHOUT COMPENSATION 28

CONCLUSION 34

CASES CITED

Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978) 30

Baldwin v. Seelig, Inc., 294 U.S. 511 (1935) 20

Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. 23 (1926) 32, 33

Burbank v. Lockheed Air Terminal, 411 U.S. 624 (1973) 23

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 22

Cox Broadcasting Corp. v. Cohn, 420 U.S. 469 (1975) 18

Federal Power Commission v. Oklahoma Corporation Commission, 362 F. Supp. 522 (1973), *summ. aff.* 415 U.S. 961 (1974) 27, 28

Florida Lime and Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963) 23

Foster-Fountain Packing Co. v. Haydel, 278 U.S. 1 (1928) 20

Page

General Motors Corp. v. Washington, 377 U.S. 436 (1964) 22

H. P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525 (1949) 19, 20

Missouri v. Kansas Natural Gas Co., 265 U.S. 298 (1924) 21

Northern Natural Gas Co. v. State Corporation Commission, 372 U.S. 84 (1963) 19, 27

Penn Central Transportation Co. v. City of New York, 438 U.S. 104 (1978) 29

Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922) 29, 33

Pennsylvania v. West Virginia, 262 U.S. 581 (1923) 19, 20

Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954) 21, 25, 26

Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) 19

Radio Station WOW, Inc. v. Johnson, 326 U.S. 120 (1945) 18

Toomer v. Witsell, 334 U.S. 385 (1948) 20

United States Trust Co. v. New Jersey, 431 U.S. 1 (1977) 30

UTAH PUBLIC SERVICE COMMISSION CASES

Re: Mountain Fuel Supply Co., 33 P.U.R. (N.S.) 3 (Utah 1940) 7, 8

Utah P.S.C. Case No. 3972 (1953) 8

Utah P.S.C. Case No. 4392 (1957) 8

Page

Utah P.S.C. Case No. 4797 (1960) 8, 10

Utah P.S.C. Case No. 5907 (1968) 8, 10

Utah P.S.C. Case No. 6369 (1972) 7, 8

Utah P.S.C. Case No. 6668 (1974) 8

Utah P.S.C. Case No. 7113 (1975) 8, 11

Utah P.S.C. Case No. 76-057-14 (1978) 10

CONSTITUTIONAL PROVISIONS

Article I, Section 8, United States Constitution 3

Article VI, United States Constitution 3

Fifth Amendment, United States Constitution 3

Fourteenth Amendment, Section 1,
United States Constitution 3

STATUTES

15 U.S.C. §§ 717-717w (1976 & Supp. 1979) 24

15 U.S.C. § 717(b) (1976) 3, 25

15 U.S.C. § 751 (1976) 3, 24, 26

15 U.S.C. § 753 (1976) 3

15 U.S.C. § 757 (1976 & Supp. 1979) 3, 25

15 U.S.C. § 760g (1976) 3

15 U.S.C. § 3201 (Supp. 1979) 24

15 U.S.C. §§ 3301-3432 (Supp. 1979) 24

15 U.S.C. § 3432(a) (Supp. 1979) 25

15 U.S.C. § 3301(21) (Supp. 1979) 3, 25

16 U.S.C. § 2601 (Supp. 1979) 24

Page

28 U.S.C. § 1257(3) (1976) 2

42 U.S.C. § 6201 (1976) 3, 24, 26

42 U.S.C. § 7255 (Supp. 1979) 24

Emergency Petroleum Allocation Act of 1973,
Pub. L. 93-159, 87 Stat. 627 ..... 23, 24, 26

Energy Policy and Conservation Act,
Pub. L. 94-173, 89 Stat. 871 ..... 24, 26

Energy Tax Act of 1978, Pub. L. 95-618,
92 Stat. 3174 ..... 24, 28

National Energy Conservation Policy Act,
Pub. L. 95-619, 92 Stat. 3206 24

Power Plant and Industrial Fuel Use Act of 1978,
Pub. L. 95-620, 92 Stat. 3289 24

Public Utility Regulatory Policy Act of 1978,
Pub. L. 95-617, 92 Stat. 3117 24

Utah Code Ann. § 54-2-1(30) (1974) 3, 13, 14, 28, 30

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. .....

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF UTAH

The petitioners, Mountain Fuel Supply Company, Wexpro Company, and Alex Oblad, Harold Burton and Carlyle Harmon, major representative Mountain Fuel shareholders, respectfully pray that a writ of certiorari issue to the Supreme Court of the State of Utah to review the judgment and opinion of that court entered in this proceeding on May 10, 1979.

OPINION BELOW

The opinion of the Utah Supreme Court, Appeal No. 15835, has been reported at 595 P.2d 871 (Utah 1979) and a copy of the same is attached as Appendix A.[1]

JURISDICTION

From the opinion of the Utah Supreme Court on May 10, 1979, timely petitions for rehearing were filed by petitioners and denied without comment on July 18, 1979. The Utah Supreme Court has stayed its remittitur of the case pending disposition of this petition for certiorari. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

I. Whether Utah regulation and taxation of interstate production and sale of crude oil and natural gas, so severe that the interstate commerce may be terminated, constitute an impermissible interference with and burden upon interstate commerce.

II. Whether Utah regulation of the price of interstate natural gas sales, which sales are subject to comprehensive pricing regulations by Congress and the Federal Energy Regulatory Commission, is preempted by federal regulation.

III. Whether Utah regulation of the economic return to the producer upon sales of oil in interstate commerce is preempted by comprehensive price regulations of the United States Department of Energy which produce, in accordance with Congress' intention, a far higher economic return.

IV. Whether Utah's retroactive reclassification of oil and gas properties as utility assets, which depresses their value by tens of millions of dollars, constitutes an uncompensated taking of the property of shareholders and bondholders contrary to their investment-backed reliance upon a Utah statute, its practical construction for over forty years, and previous final adjudications that these same properties were not utility assets.

[1] The advance sheets of the Pacific Reporter erroneously set forth counsel appearances for the parties. The Utah Public Service Commission was *without any legal counsel at any time* before the Utah Supreme Court to urge the validity and public policy of its order of April 11, 1978. That assignment consequently fell on the petitioners. Also, Calvin L. Rampton, Esq. was, at all times below, counsel for Wexpro Company.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED[2]

Article I, Section 8 of the Constitution.

Article VI of the Constitution.

Fifth Amendment to the Constitution.

Fourteenth Amendment, Section 1 to the Constitution.

Natural Gas Act, 15 U.S.C. § 717(b) (1976).

Emergency Petroleum Allocation Act, 15 U.S.C. §§ 751 & 753 (1976).

Energy Policy and Conservation Act, 15 U.S.C. §§ 757 & 760g and 42 U.S.C. § 6201 (1976 & Supp. 1979).

Natural Gas Policy Act, 15 U.S.C. § 3301(21) (Supp. 1979).

Utah Public Utilities Act, Utah Code Ann. § 54-2-1(30) (1974).

STATEMENT OF THE CASE

1. *The Nature of the Dispute.* This controversy concerns the State of Utah's constitutional power to regulate interstate com-

[2] **Copies of the relevant portions of the constitutional and statutory provisions are attached as Appendix E.**

merce in oil and gas, a commerce already regulated by the United States, and to do so by a retroactive reclassification of non-utility oil and gas properties as utility assets. Issues argued below included preemption by federal regulation, undue burden on interstate commerce, and the taking of property without just compensation.

For almost 40 years, petitioner Mountain Fuel Supply Company ("Mountain Fuel"), which operates a natural gas distribution utility, has also conducted one of the most successful oil and gas exploration and development programs in the Intermountain West. It has done so with the full knowledge and express support of the Utah Public Service Commission ("Utilities Commission"). Gas found was placed in a utility account and dedicated to the distribution utility at a cost-of-service price far below the interstate and intrastate market price. Oil found was placed in a non-utility account and sold at market price.

The Utilities Commission required this segregation into utility and non-utility accounts and, in a series of contested, final, and unappealed orders, has repeatedly held that the oil properties, most of which are in Wyoming and states other than Utah, were non-utility and not subject to Utah regulation. Every piece of property at issue here was involved in one or more hearings and was classified as a non-utility asset by a final order.

The capital costs of joint exploration and development for both oil and gas were financed by Mountain Fuel's shareholders and by the sale of debt securities. Portions of some expenses (primarily for drilling that resulted in dry holes) were allocated to the utility accounts in a manner approved by the Utilities Commission. From 1960 to 1972, the non-

utility oil accounts paid a share of dry hole expenses in proportion to their share of revenues and thereafter have paid more than that proportion.

This case arose in late 1976 when Mountain Fuel transferred its non-utility oil properties and operations to a wholly-owned subsidiary, petitioner Wexpro Company ("Wexpro"). The Utilities Commission, after exhaustive hearings, approved the arrangements between Mountain Fuel and Wexpro after modification, adhering to the position, relied upon by Mountain Fuel's stockholders and bondholders, that the properties transferred were non-utility. That position was based upon the Commission's long-standing construction of the pertinent Utah statutes and specific findings of fact in contested hearings with respect to the properties.

The Utah Supreme Court reversed. It fashioned a test under which virtually all of the non-utility properties must be reclassified as utility properties and the profits on Wexpro's sales of oil and gas from Wyoming and other states must be subjected to Utah regulation to subsidize yet lower rates to Utah natural gas ratepayers who already pay the lowest metropolitan area rates in the nation.

Certain consequences stemming from the new interpretation of the Utah statutes by the Utah court are undeniable and were not controverted below.

First, shareholders and bondholders, who relied upon previous final orders of the Utilities Commission applying the Utah statutes that the oil properties were not subject to regulation, have retroactively lost tens of millions of dollars of their property and of the security for their debentures.

Second, the conversion of a high-risk, free market business into a high-risk, low-return utility operation means that petitioners will almost certainly be forced to close down, as now unprofitable and impossible to finance, one of the nation's most successful energy exploration and development programs. The energy program which will be shut down is in the Intermountain West, one of the most prolific on-shore areas in the country for new discoveries of oil and gas.

Third, Utah, a consuming state, has undertaken to regulate oil and gas production and sales in the producing states of Wyoming, Colorado and other states, with the effect of impeding interstate commerce.

Fourth, the price of interstate sales of gas, regulated nationally by Congress and the Federal Energy Regulatory Commission, will now be fixed at lower levels by Utah in order to benefit local, Utah consumers.

Fifth, the return to the producer on interstate sales of oil, controlled by price regulations of the United States Department of Energy to encourage new production, will now be greatly depressed by Utah in order to subsidize local natural gas consumers.

The dispute between the parties concerns the constitutional power of Utah to accomplish these results in the way it did.

2. *Origin and Functions of Mountain Fuel.* Mountain Fuel was created by a 1935 merger of five companies, one of which produced oil. (R. 4394, 4945, 5512-13) For decades, Mountain Fuel has operated separate utility gas and non-utility oil businesses. (R. 4393-94) Its distribution of natural gas subjects it to public utility regulation in Utah and Wyoming, while its production and transmission functions are under federal and other state regulation. Mountain Fuel's independent, non-utility businesses include the production and sale of oil and the production of gas as well as the manufacture and sale of brick, ceramics, and other building materials, none of which has ever been subject to state utility regulation. *Re: Mountain Fuel Supply Co.*, 33 P.U.R. (N.S.) 3 (Utah 1940); *Utah P.S.C. Case No.* 6369 (1972) (R. 5728, 5734-36); (R. 226, 3800 [17])

3. *The Exploration and Development Program.* For many years, the Company's utility and non-utility divisions carried on a vigorous joint exploration and development program. Mountain Fuel investors have always borne the capital costs of land acquisition for both utility and non-utility exploration. (R. 4392) If the program produced a successful well, it was classified as either oil or gas, depending upon which had the greater "value of production" at the wellhead. (R. 4722-23) If a gas formation was discovered, all associated costs were capitalized in the utility accounts and reflected in the rates. In the event of an oil well discovery, the entire cost was capitalized in the Company's non-utility oil accounts and was, therefore, not taken into account in establishing natural gas rates. (R. 5614, 5706)

Dry holes, which produce neither gas nor oil, are necessarily treated differently. In the early years, when most wells were gas, dry hole expenses were principally reflected in the utility accounts. Even then, the non-utility oil division paid a larger proportion of drilling expense than its proportion of total Company oil and gas revenues. (R. 3792[8], 3800[24], 5723) As oil became a significant contributor to Mountain Fuel revenues, its share of joint exploration expense rose and

since 1975, has stood at half. *Utah P.S.C. Case No.* 7113 (1975) (R. 5817-18) The share allocated to the utility gas accounts affects natural gas rates. The share paid by non-utility oil accounts does not.

The Utilities Commission has always *required* Mountain Fuel to segregate non-utility oil properties from utility gas properties and operations. The Commission *forbade* Mountain Fuel to include oil properties in the utility rate base upon which an authorized rate of return on plant was allowed. This was done in seven separate rate orders from 1940 to 1978.[3] These seven proceedings were all contested and all went to final orders from which no appeals were taken. During these years the joint exploration and development program was carried on with the express approval of the Commission as to the utility division's participation.

Mountain Fuel also has historically conducted joint exploration and development with other independent producers who, upon discovering gas, sold the gas at market price to Mountain Fuel in interstate commerce for delivery and consumption in Utah.

4. *Ratepayer Benefits from the Program.* Mountain Fuel has always found substantially more gas (better than 1.5 trillion cubic feet between 1950-1976) than oil. (R. 3666, 5033, 5636) Its cost-of-service gas (actual production cost plus a utility rate of return) has always been priced well below market. In 1977, for example, Mountain Fuel customers paid $.40 per Mcf for Company cost-of-service gas as compared with a

[3] **Re: Mountain Fuel Supply Company, 33 P.U.R. (N.S.) 3 (1940); Utah P.S.C. Case No. 3972 (1953) (R. 5502-03); Utah P.S.C. Case No. 4392 (1957) (R. 5621); Utah P.S.C. Case No. 4797 (1960) (R. 5636); Utah P.S.C. Case No. 5907 (1968) (R. 5706-07); Utah P.S.C. Case No. 6369 (1972) (R. 5728); Utah P.S.C. Case No. 6668 (1974) (R. 5803).**

field price of $1.17 and a pipeline price of $1.48. (R. 5031) Mountain Fuel's gas transmission system, built only because of its exploration and development program, enabled the Company to purchase an additional one trillion cubic feet between 1960-1976 (R. 3666), giving Mountain Fuel a reserve life index of between 14 and 15 years, compared with the national average of nine years. (R. 2030) In 1979, over 30 percent of Mountain Fuel's utility gas requirements are being supplied from its own wells, a result unmatched by any other comparable gas distribution utility

In the period 1960-1976, rates were reduced $123 million by lower gas prices due to the exploration and development program. (R. 2391) Rates were reduced an additional $93.8 million due to tax deductions generated by the program (R. 3638), for a total benefit to the ratepayers of $216.8 million. As a consequence, Mountain Fuel has the lowest metropolitan area natural gas rates in the nation. (R. 389)

5. *The Ratepayer Risk Issue.* The Utah Supreme Court held that Mountain Fuel's non-utility oil properties must be taken to subsidize its utility ratepayers. This holding was based on the assumption that the ratepayers took the risks of the program by paying certain exploration expenses in their rates. (App. A8-9) The court dedicated the oil properties to the ratepayers on this money-at-risk notion. Although a misnomer, "ratepayer contribution" to the program was much smaller than shareholder contribution. In the period 1960-1976, a recovery of $44.9 million was authorized in the rates. (R. 3638) In that same period, investors contributed $87.7 million to capital costs associated with utility gas exploration (R. 3639) and $42.9 million for costs associated with oil (R. 5439), making a total contribution of $130.6 million.

Investors thus contributed nearly three times as much as ratepayers "contributed."

Moreover, whatever the comparative contributions of investor and ratepayer, the magnitude of the contributions had nothing to do with risk. All of the investor contribution was at risk while none of the so-called "ratepayer contribution" was. (R. 2452, 2514-15, 2523, 2746) That is manifest from the fact that the Utilities Commission ruled in three cases—in 1960, 1968 and 1978[4]—that it would allow a reasonable exploration expense in the gas utility rates only so long as the cost-of-service of developing new supplies of Company production was lower than the average cost of purchased gas. The ratepayers could not lose; the shareholders and bondholders could.

6. *Interstate Commerce.* Virtually all of the non-utility oil properties transferred to Wexpro on January 1, 1977, were outside Utah, the principal producing properties being in Wyoming, Colorado, and Nevada. (See Appendix C) All of Wexpro's oil operations and substantially all of Mountain Fuel's gas operations involve interstate commerce. Crude oil is sold in interstate commerce to refineries or other producers in many states at prices subject to federal regulation. (R. 970-71) Natural gas sales at the wellhead, in intrastate as well as interstate transactions, are also subject to comprehensive federal regulation.

Mountain Fuel has constructed an interstate transmission system from Colorado through Wyoming to Utah along with

[4] **Utah P.S.C. Case No. 4797 (1960) (R. 5639); Utah P.S.C. Case No. 5907 (1968) (R. 5663); Utah P.S.C. Case No. 76-057-14 (1978) (R. 3393, 3395). In the 1968 case, the Utilities Commission said:**

> **[A] vigorous exploration and development program should be continued so long as the costs incurred in developing new supplies of gas are lower than the average cost of purchased gas. (R. 5663)**

a major gathering network, compressor stations, and allied capital facilities. These facilities are under federal regulation. (R. 4570) They are shown on Appendix D. Because of its exploration and development program, Mountain Fuel was able to supply natural gas to northwestern, southwestern and midwestern consuming states during the harsh winter of 1976-1977. (R. 5504[3])

7. *Investor Reliance.* Capital contributions by investors for both oil and gas were made in reliance upon the segregation of the non-utility oil from the utility gas. (R. 5149-51) Shareholders purchased Mountain Fuel stock, which is traded on the New York Stock Exchange, in reliance upon the Utility Commission's repeated final and unappealed but contested decisions that the Company's oil properties are unregulated, non-utility assets. Bondholders, as well, purchased in reliance upon the non-utility character of the oil properties. As a result, the Company has raised debt capital at low costs to utility ratepayers. *Utah P.S.C. Case No.* 7113 (1975) (R. 5822)

8. *Formation and Transfer to Wexpro.* The non-utility oil properties were transferred by Mountain Fuel in return for all outstanding Wexpro stock. (R. 346-47, 5340) Wexpro was created to encourage and expand oil and gas exploration and development activities. The market value of the non-utility oil properties transferred was estimated to be in excess of $150 million, the entire cost of which had been paid by shareholders from earnings or the sale of securities. No part of these costs was ever recovered in utility rates. (R. 4393, 4406)

Wexpro and Mountain Fuel also entered into a 1977 Joint Exploration Agreement ("JEA"), approved by the Commission upon hearing, in which each agreed to advance one-

half of annual exploration expenses, with Mountain Fuel capitalizing and receiving any gas discoveries and Wexpro capitalizing and receiving any oil discoveries. It was anticipated that Wexpro would also explore and develop independently of Mountain Fuel, raising its own capital to do so. (R. 250, 277)

9. *Position of Respondents.* Respondents did not contend before the Utilities Commission that the non-utility assets should be rolled into or merged with the utility gas accounts for ratemaking purposes. They expressly disclaimed that argument and instead asked the Commission to attach certain conditions to the Wexpro transfer. (R. 674, 3785-91) On appeal, respondents for the first time argued that the ratepayer should receive, along with low-priced cost-of-service gas and high reserves, all of the oil assets and profits above a regulated utility rate of return.

10. *Utilities Commission Holding.* On April 11, 1978, the Utilities Commission approved the JEA and found that non-utility oil properties transferred to Wexpro were not subject to regulation. It cited the precedent of 38 years of final adjudications and orders of the Utilities Commission as to the non-utility character of the oil assets and that an exploration expense would be allowed in the rates only so long as the costs of that program reflected in the rates were lower than the average price of purchased gas.[5] (App. B11-15, 17-18, 28-30, 32, 35, 44)

It further found that Mountain Fuel shareholders and bondholders had relied upon the final orders of the Utilities Commission and its regulatory policy on the oil and gas exploration and development program in investing in the Company (App. B17-18, 22, 39-40) and that the program had been in the public interest and should be continued in the future under the JEA with Wexpro. (App. B39-40, 85-86)

[5] The Report and Order of the Utilities Commission of April 11, 1978 is attached as Appendix B.

11. *Utah Supreme Court Holding.* Upon direct appeal, the Utah Supreme Court, in a divided opinion, held that the non-utility oil properties had always been and are utility assets,[6] and that these properties and the oil revenues generated from them should be "applied, to reduce the cost of gas" to the Utah utility customer. (App. A8-9) The court majority did not mention the separation of utility gas and non-utility oil required by the Commission for almost 40 years, or the seven previous, separate final orders of the Commission adjudicating the oil properties of Mountain Fuel to be non-utility, unregulated assets.

The Utah Supreme Court majority did not cite nor discuss that portion of the Utah statute providing that regulation of a utility by the Commission shall not extend to any non-utility business conducted by the utility. Utah Code Ann. § 54-2-1 (30) (1974). The court held that the Commission's conclusions were "premised on the erroneous assumption there was no correlation or connection between the contributions by the ratepayers, through an annual exploration and development expense included in the rate base, and the ensuing benefits from the program." (App. A2)

[6] The Utah court wrote out a three-pronged economic test to determine whether the non-utility oil properties were utility assets, viz., (1) was the property, while undeveloped wildcat acreage, ever reflected, even momentarily, in a utility account earning a rate of return, (2) were any utility exploration expense funds applied to develop that acreage or (3) have natural gas or gas liquids ever been produced from the acreage, regardless of amount. (App. A13-14) Petitioners acknowledge that under this new test, substantially all of the non-utility oil properties would fall within the sweeping contours of what the Utah court has now announced to be "utility property."

Ignoring the fact that the Commission had precisely recognized that connection and explained its relevance, the court majority, on the basis of a new theory that Mountain Fuel stood in a "trust relationship" when it sold natural gas to its utility customers (App. A4, 8), held that (i) sales of interstate gas by Wexpro to Mountain Fuel must be at the cost-of-service price rather than the federal ceiling price, even when the gas comes from acreage independently developed by Wexpro (App. A5-6), and (ii) Wexpro, along with any other company in interstate commerce that sells jointly developed gas to Mountain Fuel, is itself a public utility subject to Utah regulation. The Utah court stated:

> A review of the provisions of the two agreements as modified by the Commission clearly indicates that, by the activities performed by Wexpro, it becomes a public utility subject to the jurisdiction and regulation of the Commission under Sec. 54-2-1(30). *Wexpro, by its joint activities with Mountain Fuel*, particularly upon the transferred properties *is both performing a service, viz., facilitating the production of natural gas, and delivering natural gas to its parent, both of which constitute Wexpro a public utility.* (App. A13) (Emphasis added)

These concepts, taken together, leave no room for Mountain Fuel or Wexpro to conduct a non-utility business in oil or gas, subject Wexpro to Utah regulation as a public utility, and require Wexpro to sell gas to Mountain Fuel at cheap prices (App. A5-6), far below the federal ceiling level for comparable vintage supply. Further, under the statutory interpretation of the Utah court, any other independent producer which explores "jointly" with and delivers gas to Mountain Fuel, whether in interstate commerce or not, "facilitat[es] the production of natural gas" and is, as well, subject to Utah regulation.

Justice Wilkins, in dissent, concluded that the majority's ruling was contrary to the Utah statutes and to the many final decisions of the Utilities Commission, that the Utah court had ignored decisions of this Court under the Fourteenth Amendment, and that the decision constituted a "massive appropriation of the property rights of Mountain Fuel's shareholders." (App. A52-56) The dissent noted that the remand to the Utilities Commission would be a mere mechanical accounting procedure because the Commission had found facts and the court majority had stated conclusions that required the reclassification of the properties in question from non-utility to utility. (App. A41-42, 53)

12. *Termination of Mountain Fuel Exploration and Development.* The evidence shows, and it has never been denied, that if the non-utility oil properties were folded into the gas utility accounts for ratemaking, the 43-year-old exploration and development program of Mountain Fuel would end. (R. 2006, 5028, 5033) Mountain Fuel competes for capital funds against oil and gas companies who receive the highest interstate price for both crude oil and natural gas, even though such companies also recover an exploration expense in their rates and prices. (R. 4175, 4410-11) The subsidization of Utah gas consumers with oil profits, and the requirement that Wexpro sell gas independently discovered in other states to Mountain Fuel at low, cost-of-service prices, will make it impossible to raise risk capital for the program. (R. 155-56, 350, 385-89)

REASONS FOR GRANTING THE WRIT

Utah will now regulate both the price of natural gas moving in interstate commerce and the rate of return on interstate sales of oil. The State has also taken tens of millions of dollars of oil properties belonging to petitioners in order to

give a one-time windfall to Utah gas utility customers through temporarily lowered rates. These actions by Utah raise serious constitutional issues of interference with interstate commerce, state regulation of subjects preempted by federal law, and the uncompensated taking of private property.

This case is one of great public importance and widespread significance, particularly at a time when energy shortages present an urgent problem for solution at national and international levels. Utah has attempted to appropriate energy resources in interstate commerce, much of which does not even touch Utah's borders, for purely local benefit. This is not the first time in our history, nor will it be the last, that this Court has been asked to preserve the federal plan against local incursion. In times of economic difficulty, states are under strong temptation to prefer local and short-term interests to national and long-term goals. Utah has succumbed to that temptation. If its attempt succeeds and the decision below stands, other states and localities will be encouraged to similar attempts, if only in self-defense. Further litigation of this kind is a certainty.

The issues here do not turn upon Utah's utility laws but on principles of federal constitutional law. It could not be more clear that petitioners do not invite this Court to determine the wisdom or propriety of the "no-profit-to-affiliate" concept or the three-pronged utility test under the Utah court opinion. Nor do petitioners request in any sense that this Court enter upon or become enmeshed in an accounting or classification proceeding as to the non-utility or utility character of the oil properties. There is no issue presented involving the classification of oil or gas assets. Rather, petitioners complain only of the resulting impact of the Utah opinion upon

the production and sale of oil and gas in interstate commerce, upon preemptive federal law and policy, and upon constitutionally protected property rights. This petition is so confined.

That Utah has acted in the guise of regulating a distribution utility neither justifies its action nor narrows the scope of the precedent. Hence, Utah's announced rationale for interfering with interstate commerce and federal regulation — that its utility ratepayers bore the risk of out-of-state exploration and development — does not, even if it were true, empower Utah to fix oil profits and gas prices it is constitutionally barred from regulating.

The controlling constitutional rules should be authoritatively stated now.[7] With Utah's action as precedent, other

---

[7] The federal constitutional questions asserted by this petition were raised below and decided against petitioners. The decision is subject to no further review in Utah. Nothing remains to be done except the implementation of the judgment by the Utah Utilities Commission. Justice Wilkins, in his dissent below, characterized the remand to the Commission as "demonstrably needless" because the criteria framed by the Utah court had appropriated all Wexpro's assets under the Commission's undisputed findings. (App. A41-42, 53)

In response to the petitions for rehearing below, respondents adopted the opinion of Justice Wilkins on the nature of the remand, arguing that all of Wexpro's oil profits and properties were to be utilized to lower Mountain Fuel natural gas rates. Petitioners, however, urged on rehearing that the Utah court judgment could be interpreted as resulting in a roll-in of less than all of the oil profits and properties. The Utah court did not respond.

Under any interpretation, there is no question that on remand Utah will regulate interstate commerce contrary to the Constitution and Congressional preemption and that petitioners will suffer an immense loss in property values and profits of at least tens of millions of dollars and perhaps as much as $150 million. The sole reason these results have not already occurred is that the Utah Supreme Court stayed its remittitur of the matter to the Commission so that petitioners could seek review in this Court of the substantial federal questions presented.

This case is mature for review by this Court because the federal

(Note continued on next page)

states and local units of government will attempt to seize non-utility assets of other shareholders and bondholders to subsidize local consumers at the expense of national interests in energy development, thus obstructing vital and comprehensive federal energy policies.

I.

UTAH'S EXTRATERRITORIAL REGULATION IS AN IMPERMISSIBLE INTERFERENCE WITH AND BURDEN UPON INTERSTATE COMMERCE.

Utah has obstructed interstate commerce in three ways:

1. By appropriating Wexpro's profits on sales of Wyoming, Colorado, and Nevada oil in order to subsidize natural gas prices charged Utah ratepayers by the parent, Mountain Fuel;[8]

2. By requiring Wexpro to lower the price of interstate natural gas sales to Mountain Fuel by approximately 68 per-

---

Continued

questions have been resolved with finality, the regulation and taking are certain and all that remains is an accounting proceeding. **Cox Broadcasting Corp. v. Cohn,** 420 U.S. 469 (1975); **Radio Station WOW, Inc. v. Johnson**, 326 U.S. 120 (1945).

Review at this time is essential to preserve petitioners' rights. Continuation of the gas and oil exploration and development program depends upon the continuing commitment of risk capital and the retention of highly skilled management and technical personnel. Neither of these is possible if Utah's action is likely to stay in effect. Complex and high risk undertakings of this sort cannot be stopped and started at will. Hence, later review, after extended proceedings before the Commission, would in all probability come too late, no matter what the outcome, to save petitioners' exploration and development program and operations.

[8] If the non-utility oil properties are folded into the utility gas accounts for ratemaking purposes, Mountain Fuel's cost-of-service production would come to Utah customers at $.16/Mcf rather than the already low 1977 average price of $.40/Mcf.

cent from the federal ceiling price of $1.17/Mcf to the state regulated price of $.40/Mcf;[9] and

3. By subjecting to Utah utility regulation the wellhead price and sales of other producers who jointly produce natural gas with Mountain Fuel outside of Utah and sell that gas to Mountain Fuel for interstate transmission to Utah.

There is no doubt on this record, or indeed, in common sense, what the results of Utah regulation will be. Wexpro and Mountain Fuel will in all probability have no other option than to cease efforts to find new discoveries of and to develop oil and gas. Neither Wexpro nor Mountain Fuel can attract risk capital for oil and gas exploration when the best that can be expected is a low distribution utility rate of return.

Three lines of authority condemn Utah's extraterritorial regulation of natural gas and oil sales.

First, Utah's regulation of oil and gas is invalidated by the Commerce Clause under *Pennsylvania v. West Virginia*, 262 U.S. 581 (1923); *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963); *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525 (1949); and *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

Pennsylvania v. West Virginia, supra, held unconstitutional a West Virginia statute requiring producers and distributors to satisfy local consumers before shipping to Ohio and Pennsylvania. This Court stated:

> Natural gas is a lawful article of commerce, and its transmission from one state to another for sale and

---

[9] Based on a comparison of Mountain Fuel's average cost-of-service price for its own gas with its average field producer price for the year 1977. (R. 5031)

> consumption in the latter is interstate commerce. A state law, whether of the state where the gas is produced or that where it is to be sold, which by its necessary operation prevents, obstructs, or burdens such transmission, is a regulation of interstate commerce, —a prohibited interference. 262 U.S. at 596-97.

This Court has frequently reaffirmed the fundamental principle of *Pennsylvania v. West Virginia* which prevents a state from impeding the channels of interstate commerce or erecting anti-competitive barriers to the free flow of goods for the benefit of local consumers. *H. P. Hood & Sons, Inc. v. Du Mond, supra; Toomer v. Witsell*, 334 U.S. 385 (1948); *Baldwin v. Seelig, Inc.*, 294 U.S. 511 (1935); *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1 (1928). *Baldwin* held unconstitutional a New York law prohibiting the importation of milk unless it had been purchased in the producing state at prices no lower than New York required its producers be paid.

Utah's statutes, as now interpreted, require that natural gas, produced and sold in Wyoming in interstate commerce, but destined for Utah, be sold at a regulated Utah price well below applicable federal prices for the benefit of Utah consumers. As a consuming state, Utah has interfered with interstate commerce to protect local consumers, as in *Pennsylvania v. West Virginia*. Utah has also extended its regulatory arm into the producing state of Wyoming, as in *Baldwin*, when its only basis for utility jurisdiction is the retail distribution of natural gas in Utah.

Moreover, the Utah scheme reaches even further beyond constitutional limits when its subsidizes its Utah customers by exporting its state regulation to millions of dollars of Wexpro profits for the sale of oil in interstate commerce in Wyoming and Colorado when that oil is not even destined for use in the consuming state.

The State of Wyoming was so concerned with the application of the Utah regulation to Wyoming producers that it filed a brief *amicus curiae* in connection with the petitions for rehearing below. Wyoming noted that the Utah statute was interpreted to apply to all interstate producers selling gas to Mountain Fuel and asked:

> [D]oes the Court's application of the Utah statute mean that a producer of natural gas in Wyoming may be held subject to the jurisdiction of the Utah Public Service Commission as a public utility if it sells gas to Mountain Fuel?

The Utah court had already given a clear affirmative answer to the Wyoming question in its opinion and did not trouble to reanswer the question on rehearing.

Second, decisions of this Court beginning with *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924) and culminating in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), establish the principle that the wellhead price of natural gas sold for transportation or resale across state lines is itself a transaction in interstate commerce and so not subject to state regulation. Wexpro in this case stands in precisely that position. *Phillips* invalidates Utah's regulation of interstate gas sales to Mountain Fuel by Wexpro and other producers.

Third, whatever label is used, Utah's appropriation for local ratepayers of Wexpro's profits on oil sales in Wyoming, Colorado, and Nevada is analogous to, and indeed indistinguishable from, a tax upon those interstate sales. Any profit

Wexpro makes above a fixed utility rate of return on a sale of regulated oil, is to be taken and redistributed to Mountain Fuel's consumers in the form of cheap gas rates. The fact that the local consumer-beneficiaries are less than all of the citizens of Utah does not make the exaction any less a tax, for numerous taxes are levied for the benefit of particular classes.

The controlling law on state taxation of interstate commerce is stated in *General Motors Corp. v. Washington*, 377 U.S. 436, 441 (1964):

> [T]he decisive issue turns on the operating incidence of the tax. In other words, the question is whether the State has exerted its power in proper proportion to appellant's activities within the State and to appellant's consequent enjoyment of the opportunities and protections which the State has afforded.

All of the cases hold that there must be *some* nexus between the commerce and the state taxing it and *some* fair proportionality between the tax and the company's activities within the state. *See, e.g., Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Here there is neither. Utah is taxing interstate commerce in oil which does not even touch its borders. Petitioners have found no case with a tax like this one because no other state has attempted such a bold and rapacious charge on interstate commerce.

Moreover, there exists the prospect of multiple taxation. Mountain Fuel operates as a gas distribution utility under local regulation in Wyoming as well as in Utah. If Utah may tax Wexpro's Wyoming, Colorado and Nevada oil sales because Mountain Fuel is a distribution utility in Utah, certainly Wyoming may also tax Wyoming oil sales and Wexpro's oil sales in Utah, Colorado and Nevada as well.

What has really happened here is this: Utah, without any nexus to the interstate commerce and having no taxable incidence of Wexpro's oil business or profits, has nonetheless undertaken to tax that oil commerce so severely that it will end — and it has done so under a rationale that will permit other states to levy similar taxes on the same commerce.

Under all relevant authority, Utah has interfered with interstate sales and movements of oil and natural gas in a manner rendered impermissible by the Commerce Clause of the Constitution.

II.

UTAH'S REGULATION IS PREEMPTED BY FEDERAL REGULATION OF OIL AND NATURAL GAS SALES.

Utah has regulated both oil and gas in conflict with federal statutes and policy.[10]

A. *General Framework of Preemptive Federal Oil and Natural Gas Regulation.*

Production and sale of natural gas and crude oil has been a field of intense federal concern and comprehensive, detailed federal regulation for decades. Commencing with the passage of the Natural Gas Act of 1938, continuing with the Emergency Petroleum Allocation Act of 1973, and culminating in a

---

[10] **The doctrine of federal preemption extends not only to state laws or actions that conflict with particular federal statutes, but also to state actions which attempt to operate in a field already occupied by Congress or which frustrate the achievment of federal policy. Burbank v. Lockheed Air Terminal, 411 U.S. 624 (1973); Florida Lime and Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963).**

series of energy enactments in 1978,[11] Congress has completely occupied the field. State regulation of interstate production and sales of oil and gas has been ousted and national policies established in direct conflict with what Utah has done here. The national government has taken the more recent of these actions in response to the worst energy crisis in the history of this country. Its policy is to develop national markets for oil and gas with uniform prices, to stimulate new exploration and development through price incentives, and ultimately to phase out regulation in favor of competitive pricing.[12]

So complete is the federal domination of this field that even the traditional area of state regulation, natural monopoly distribution, has been subjected to federal standards in control of wasteful practices, rate design, incremental pricing and the

[11] Natural Gas Act, 15 U.S.C. §§ 717-717w (1976 & Supp. 1979); Emergency Petroleum Allocation Act of 1973, Pub. L. 93-159, 87 Stat. 627; Energy Policy and Conservation Act, Pub. L. 94-173, 89 Stat. 871; Natural Gas Policy of 1978, 15 U.S.C. §§ 3301-3432 and 42 U.S.C. § 7255 (Supp. 1979); Public Utility Regulatory Policy Act of 1978, Pub. L. 95-617, 92 Stat. 3117; Energy Tax Act of 1978, Pub. L. 95-618, 92 Stat. 3174; National Energy Conservation Policy Act, Pub. L. 95-619, 92 Stat. 3206; Power Plant and Industrial Fuel Use Act of 1978, Pub. L. 95-620, 92 Stat. 3289.

[12] The statutory declarations and legislative history leave no room for argument that a national policy for the uniform pricing of oil and gas in or affecting interstate commerce and for providing price incentives for new production is plainly intended by the Congress. See, 15 U.S.C. §§ 751 & 3201 (1976 & Supp. 1979), 16 U.S.C. § 2601 (1976) and 42 U.S.C. § 6201 (1976). Public Utility Regulatory Policy Act of 1978, H.R. Rep. No. 95-543, p. 10, states:

> The natural gas pricing policy adopted by the [Conference] Committee establishes a single, uniform price for natural gas produced in the United States.

See also, Natural Gas Policy Act of 1978, H.R. Rep. No. 95-1752 and Energy Tax Act of 1978, S.R. No. 95-436, p. 20, where the Senate Committee on Energy and Natural Resources stated:

> The Administration is proposing a system under which price controls would be made more consistent with national policies. Producers would be given adequate price incentives for development of new fields.

production and sale of intrastate oil and gas. In short, federal regulation has been extended to completely eclipse state regulation in this field.[13]

B. *Federal Preemption of Natural Gas.*

Against the background of the comprehensive federal framework just examined, the invalidity of Utah's regulation of both gas and oil is clear.

With respect to gas, the Natural Gas Act preserves for exclusive federal jurisdiction "the sale in interstate commerce of natural gas for resale for ultimate public consumption . . . and [sales] to natural-gas companies engaged in such transportation or sale . . . ." Natural Gas Act, 15 U.S.C. § 717(b) (1976). *See also*, Natural Gas Policy Act, 15 U.S.C. § 3301(21) (Supp. 1979).

In *Phillips Petroleum Co. v. Wisconsin, supra,* this Court held:

> [T]he legislative history [of the Natural Gas Act] indicates a congressional intent to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company. 347 U.S. at 682.

Utah's regulation here is not a regulation of transactions between a Utah utility and its Utah customers. It is, rather, a regulation of interstate sales of natural gas for resale as defined by the Natural Gas Act. The regulated sales are also

[13] A state may not regulate any price of oil even though produced and consumed intrastate. 15 U.S.C. § 757 (1976). It may still regulate the sales price of gas produced and consumed wholly intrastate, provided however that the price in all events does not exceed the federal maximum ceiling for comparable vintaged gas. 15 U.S.C. § 3432(a) (Supp. 1979).

transactions by a "natural-gas company" within the Act's coverage as settled by *Phillips*. Under that decision, regulation of sales by an independent natural-gas producer is the same as regulation of sales "by an affiliate of an interstate pipeline company." 347 U.S. at 685. Thus, sales from Wexpro and others to Mountain Fuel are "first sales" in interstate commerce and immune from state regulation.

C. *Federal Preemption of Oil.*

With respect to oil (as well as natural gas), one of the central objectives of the comprehensive energy legislation, as set out in the Energy Policy and Conservation Act, is *"to increase the supply of fossil fuels* in the United States *through price incentives and production requirements."* 42 U.S.C. § 6201(3) (1976) (Emphasis added.) *See also,* Emergency Petroleum Allocation Act, 15 U.S.C. § 751(a)(1) (1976).

The Utah regulation completely and effectively frustrates this federal policy. The uncontroverted fact is that as a result of the Utah scheme, one of the nation's most successful exploration and development programs will be compelled to phase out and end. The precise reason is that Utah has taken away the "price incentives" that Congress intended. By requiring that profits from oil sales be used to subsidize natural gas rates, the consuming State of Utah has eliminated all incentive and economic capacity for Mountain Fuel shareholders to continue to bear the risk and expense of further exploration and development. This form of oil regulation is an open invitation to other consuming states to regulate by seizing the profits from oil production and collapsing those profits into local gas distribution utility rates.

The fact that Utah's regulation is by way of seizing profits on Wexpro's oil sales, and not regulation of the sales price,

does not lessen the frustration of federal preemptive policy. Requiring Wexpro to dedicate its oil profits to lower Utah utility gas rates is destructive of the federal objectives of price incentive and new production and thus has exactly the same impact as state regulation of the price itself. That regulation is in conflict with and condemned under the seminal authority of *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963). Although *Northern Natural* dealt with the Natural Gas Act, the analogy here is direct:

> The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, [citation omitted] or for state regulations which would indirectly achieve the same result. These state orders necessarily deal with matters which directly affect the ability of the Federal Power Commission [now FERC] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain. 372 U.S. at 91-92. (Emphasis added)

In *Federal Power Commission v. Oklahoma Corporation Commission*, 362 F. Supp. 522 (1973), *summ. aff.* 415 U.S. 961 (1974), Oklahoma attempted, in the name of local conservation, to "shut-in" wells dedicated to interstate commerce having a cheap casinghead price for the benefit of Oklahoma producers and consumers. A three judge federal court invalidated the state regulation as inconsistent with the preemptive authority of the Federal Power Commission and also as an intolerable burden upon commerce. This Court summarily affirmed.[14]

---

[14] The dissents of Justices Rehnquist, Stewart and Powell were not "from any disagreement with the substantive holding of the District Court," but ran to the standing of the FPC to prosecute the action. 415 U.S. at 963.

Federal preemption of the regulation here follows, *a fortiori*, from the *Oklahoma Corporation Commission* holding. There, the announced purpose of the regulation was energy conservation which is also a federal policy. The Utah regulation results in lower production of oil (because of decreased profits) and higher consumption of gas (because of artificially lower rates), each of which runs squarely counter to federal energy policy:

> Government policy . . . should provide for prices that encourage development of new wells through a more effective distribution of production incentives [and] should also promote conservation by confronting [consumers] with the real cost of oil and gas in the energy marketplace. Energy Tax Act of 1978, S.R. No. 95-436, p. 20.

If allowed to spread to other states, Utah's conflicting regulation will not only balkanize the national oil and gas markets, it will destroy the development of a comprehensive and uniform federal energy policy during an era of critical energy shortage. The burden on commerce of the attempted Utah regulation is patent; its conflict with comprehensive federal policy is startling; and the invitation to other state regulatory bodies to do likewise is undeniable.

III.

UTAH HAS UNCONSTITUTIONALLY CONFISCATED PETITIONERS' OIL PROPERTIES WITHOUT COMPENSATION.

From the beginning of its corporate existence in 1935 until 1977 when it transferred them to Wexpro, Mountain Fuel owned non-utility oil properties. It did so pursuant to the Utah Utility Code, Utah Code Ann. § 54-2-1(30) (1974),

that permits a company to own and operate both utility and non-utility businesses and provides that the latter shall not be regulated. The capital costs of acquiring, drilling and developing non-utility oil properties were paid by Mountain Fuel shareholders from capital contributions, retained earnings, and the sale of debt securities. Shareholders purchased stock and bondholders lent their credit in express reliance upon the non-utility oil functions of the Company. Mountain Fuel sold oil at the market price and realized competitive profits. So operated, the oil properties had a market value in excess of $150 million.

Mountain Fuel's shareholders owned these non-utility oil properties for 43 years, to May 9, 1979. They own them no more. On May 10, 1979, the Utah Supreme Court gave most of the value of the oil properties to Mountain Fuel's natural gas utility ratepayers. The court did so by declaring the oil assets to be "utility properties." (App. A12) Thus, Wexpro and its owner, Mountain Fuel, are now entitled only to a low utility gas rate of return, the oil profits being given to the gas customers to lower their rates further.

By subjecting virtually all of the oil properties to its regulation, Utah has taken from Mountain Fuel and its shareholders substantial oil profits and capital values of the oil properties. The bondholders have lost substantial security for the debentures they purchased.

The Utah decision is an uncompensated confiscation of petitioners' property in violation of the Fifth Amendment, made applicable to the states by the Fourteenth Amendment, under the principles enunciated by this Court in ***Penn Central Transportation Co. v. City of New York***, 438 U.S. 104 (1978) and *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922),

as well as, by close analogy, *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) and *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977).[15] The central inquiry of those cases is whether state action has interfered with or demoralized the distinct investment-backed expectation of property owners resulting in substantial loss or the devaluation of property interests.

Additional factors stressed by those cases as showing an unconstitutional taking are present here. The property values taken are substantial and the taking is retroactive. There are no alternative valuable uses for the property. Petitioners have received no compensating benefit. There is no public emergency in Utah and no strong public interest relating to these properties — other than the desire to appropriate most of their value. Legitimate, investment-backed expectations of petitioners, the shareholders, and the bondholders have been destroyed.

It is unquestioned that the shareholders and bondholders acted in justifiable reliance upon Utah law. Pursuant to the Utah Utility Code, Utah Code Ann. § 54-2-1(30) (1974), petitioners' oil business, carried on in other states, was no more a gas utility business than was Mountain Fuel's ceramic and brick business. In fact, petitioners, if anything, were more justified in their dependence upon the non-utility status of the oil business than any other, for they had not only the Utah utility statute and 43 years of practical construction upon which to rely, but also a series of final orders of the Utilities

[15] **Allied Structural Steel and United States Trust Co. involve the impairment of the obligation of contracts, but both decisions are directly relevant because the two concepts, impairment of contractual obligation and the taking of property without just compensation, are closely parallel and in some respects conceptually identical.**

Commission. The Commission decisions not only announced the principles of the segregated, non-utility character of the oil properties, but adjudicated the non-utility status of these specific properties now retroactively declared to be utility assets.

The seizure of Mountain Fuel oil properties floats, under the Utah opinion, on two theories, each patently fallacious. The first premise is that "the ratepayers [were] the primary source of risk capital throughout the years" (App. A8), because a share of the dry hole expenses proportionate to revenues was allocated to utility accounts and reflected in the rates. The defect of the argument has already been demonstrated — by a policy announced in advance, no dry hole expense would be reflected in the rates unless the exploration program resulted in gas for ratepayers at less than the cost of purchasing the same gas in the market. There was no prospect that a gas customer in paying his bill would contribute to an unsuccessful exploration and development program and, therefore, there was no risk to the ratepayer, only to Mountain Fuel and its shareholders.

Mountain Fuel was not required to explore and develop gas fields; it could have simply purchased pipeline or field produced gas. The share of dry hole expense reflected in the utility rates was a *quid pro quo* for cost-of-service gas and would continue only so long as exploration resulted in lower rates. All of this was known in advance and constituted the announced rules under which the Mountain Fuel program went forward. The ratepayer risk theory is, beyond quibble, a sham.

The second premise of the Utah court is that a utility stands in a "trust relationship to its customers" (App. A4, 8) and must undertake all steps to sell gas at the cheapest rate

to consumers, including the dedication of profits from a non-utility business. This trust-relationship notion is in square conflict with this Court's constitutional holding in *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926). The New York Commission attempted to employ in a rate case an excess depreciation reserve created by the telephone company in prior years to off-set future year deficiencies in telephone revenues. The Court held that the New York Commission could not reach back and retroactively utilize assets of prior years to offset prospective revenue deficiencies. To do so would be a confiscation of investor assets in violation of the Fourteenth Amendment.

With respect to the trust-relationship notion, the Court in *New York Telephone* said:

> The customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. *The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary.* 271 U.S. at 31. (Emphasis added)

The Court also rejected the novel theory adopted by the Utah court here that a customer acquires an interest in the assets of a seller when he pays a purchase price that covers some or all of the seller's expenses:

> Customers pay for service, not for the property used to render it. . . . *By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.* Property paid for out of money received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock. 271 U.S. at 32. (Emphasis added)

In the American economy, there is nothing remarkable about any business, utility or otherwise, recovering all of its expenses plus a profit in the price it charges for the product or service it sells — all without the customer participating in the business profits or the assets that produced those profits.

The facts in this case are much more extreme than those which were indicted as a "taking" in *New York Telephone*. In the latter, the assets and accounts which were sought to be taken by the New York Commission *were and always had been* utility properties. The oil properties of Mountain Fuel never have been.

Had Utah made a prospective decision that utilities could not own non-utility assets, this case would be very different. But Utah did not do that. The judgment below holds that the State may consistently — by express statute, by consistent practice, and by specific adjudication for over four decades — assure the investor that its policy is not to regulate oil properties, invite investment on that basis, and then, only after significant oil discoveries had been made and the world price of oil had sharply risen, deliberately break its promise and appropriate the value of the investments made.

Not only will the Utah decision blunt and demoralize the investment-backed expectations of bondholders and shareholders in the capital markets of the nation in similar instances, it will, if permitted to stand, serve as an incentive for other states to seize corporate properties to ease the economic condition of voting consumers.[16]

---

[16] **As Mr. Justice Holmes wrote for the Court in Pennsylvania Coal Co. v. Mahon, supra:**

> **We are in danger of forgetting that a strong public desire to improve the public condition [in this case by lowering local natural gas rates] is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change. 260 U.S. at 416.**

CONCLUSION

The non-utility oil properties of Mountain Fuel have been seized and expropriated by Utah without compensation in contravention of the Fifth and Fourteenth Amendments to the Constitution. In so doing, Utah has burdened interstate commerce by attempting to regulate the sale and production of gas and oil, fields which are federally preempted under the Supremacy Clause.

This petition for certiorari should be granted.

Respectfully submitted,

ROBERT H. BORK
142 Huntington Street
New Haven, Connecticut 06511

ROBERT S. CAMPBELL, JR.
310 South Main Street, Suite 1200
Salt Lake City, Utah 84101

REX E. LEE
2840 Iroquois Drive
Provo, Utah 84601
Counsel for Mountain Fuel Supply Company

CALVIN L. RAMPTON
800 Walker Bank Building
Salt Lake City, Utah 84111
Counsel for Wexpro Company

EDWARD W. CLYDE
351 South State Street
Salt Lake City, Utah 84111
Counsel for Stockholders

APPENDIX

Appendices
Table of Contents

Appendix A —
Opinion of Utah Supreme Court . . . . . A1 - A57

Appendix B —
Report and Order on Rehearing of Utah
Public Service Commission . . . . . B1 - B110

Appendix C —
Map of Non-utility Oil
Properties Transferred to Wexpro C1

Appendix D —
Map of Mountain Fuel Supply
Company's Interstate System D1

Appendix E —
Constitutional and Statutory
Provisions Involved . . . . . E1 - E8

APPENDIX A

In the Supreme Court of the State of Utah

No. 15835

Filed May 10, 1979

COMMITTEE OF CONSUMER SERVICES, Utah Department of Business Regulation, Division of Public Utilities; and Salt Lake County,

Petitioners,

v.

PUBLIC SERVICE COMMISSION OF UTAH, Millie O. Bernard, Chairman, Olof E. Zundel, Commissioner, and Kenneth Rigtrup, Commissioner,

Respondents,

Mountain Fuel Supply Company, a Utah Corporation, Wexpro Company, a Utah Corporation, and Alex Oblad, Harold Burton and Carlyle Harmon, Mountain Fuel Shareholders,

Intervenors-Respondents.

James L. Barker, Daniel L. Berman, Stephen Randle, Asst. Atty. Gen., Marcus A. Theodore, Deputy Salt Lake County Atty., Salt Lake City, for petitioners.

G. Blaine Davis, Asst. Atty. Gen., Salt Lake City, for respondents.

R.G. Groussman, Robert S. Campbell, Edward W. Clyde, Salt Lake City, for intervenors.

MAUGHAN, Justice:

Petitioners seek review of an order of the Public Service Commission approving an amended purchase and sale agreement, and an amended joint exploration agreement. Both of these were modified by the Commission. They related to Mountain Fuel Supply and its wholly owned subsidiary, Wexpro. The order is reversed and the matter is remanded for a hearing in accordance with the principles set forth in this opinion. All statutory references are to U.C.A.1953.

The order was predicated on the validity of the classification by Mountain Fuel of its utility and non-utility assets, and the conclusion the Commission had no jurisdiction over the non-utility assets and the transfer of those assets to a non-utility corporate entity. These conclusions were premised on the erroneous assumption there was no correlation or connection between the contributions by the ratepayers, through an annual exploration and development expense included in the rate base, and the ensuing benefits from this program.

The key to the nature of misunderstanding of the majority of the Commission is well expressed in the dissent of Commissioner Rigtrup, who stated:

> The Commission's Report and Order represents a fundamental abdication by the Commission of its statutory responsibility to protect the public interest. The result of this abdication, which allows the transfer to an unregulated company of well over $150 million worth of assets discovered and developed with funds provided by the ratepayers of this state, under prior order of this Commission, can only be characterized a regulatory outrage.

In the conclusion to his dissent, Commissioner Rigtrup stated:

> . . . I would conclude that the exploration acreage held by Mountain Fuel over the years was used or useful in its natural gas utility business, and should have always been classified as utility assets. The fact that revenues from 'oil' or other liquid hydrocarbons have become very significant during the last few years does not change the basic character of those assets. However, it appears that the shareholders of Mountain Fuel have come to expect an unregulated return from oil properties, for which the risk capital was largely derived in rates charged its customers as ordered by the Commission. . . .

In evaluating the order of the Commission, it is important to review the two avowed purposes of Mountain Fuel in creating Wexpro: first, to provide and maintain a vigorous exploration program in order that Mountain Fuel might secure natural gas reserves for the future; second, "to remove regulatory uncertainty from the non-utility properties of the company which has hung like Damocles [sic] sword over the properties and assets of Mountain Fuel since 1972."

The latter purpose was the consequence of a finding by the Commission, in a report and order of January 14, 1974, that the oil operations were so incidental to and inseparable from the production and sale of natural gas as to be part of Mountain Fuel's utility operations; and any other treatment would be purely arbitrary, conjectural, and speculative. The Commission had ordered the investments, revenues, and expenses of the oil operations be included in the appropriate utility accounts, for rate-making purposes. Subsequently, the Commission had rescinded the order for the "roll in" of the oil properties, but the findings were not rejected. These findings, in regard to the inseparable nature of the oil and gas opera-

tions, were the sword of Damocles Mountain Fuel sought to have beaten into a non-regulated oil derrick.

In the current order, in finding No. 42, the majority of the Commission concluded that the language of the January 14, 1974, Report and Order "with respect to the ratepayer risk, ratepayer rip-off and exploitation of Mountain Fuel customers is erroneous and should not stand as fact or law." The dissent responded it was unnecessary for the majority to overrule the prior order. The dissent stated:

> . . . The attempt of Mountain Fuel to obtain a ruling in this case which it could not get in Case No. 6668 is not only an affront to the members of the former Commission, but should offend reasonable sensitivities of this Commission.

There are certain basic principles which should be reviewed prior to the evaluation of the positions of the contesting parties.

First, it is the duty of a public utility corporation to operate in such a manner as to give to the consumers the most favorable rate reasonably possible. This duty stems from the fact the State has conferred on the utility of the exclusive right to sell and distribute gas. As a consequence, the utility bears a trust relationship to its customers and must conduct its operations on that basis and not as though it were engaged in a private enterprise with no restrictions as to its income.[1]

Second, under the general concepts of public utility law, risk capital is provided by the investor; it is this group which bears the risk of loss as developer of a public utility. It is only to the extent the facilities developed are used and useful to the consumer that they are included in the rate base.[2]

[1] *City of El Dorado v. Arkansas Public Service Commission*, 235 Ark. 812, 362 S.W. 2d 680, 683-684 (1963).

[2] *Terra Utilities, Inc. v. Public Service Commission*, Utah, 575 P.2d 1029 (1978).

Third, under the "no-profits-to-affiliates" rule, any amount paid as a profit by a company to any other with which it is directly or indirectly in a control relationship cannot properly be included in the rate base. The basis of the rule is that a profit made by an enterprise dealing with itself does not represent a cost. The rationale underlying this concept proceeds from a simple premise:

> If the relationship between two contracting parties is so close that they lose their individual identity and are, in fact, *one*, there can be no 'actual legitimate cost' involved in the payment of profits, since it would be tantamount to a company's paying *itself* a profit for interdepartmental services. [Citations][3]
>
> . . . Intracompany transactions cannot be used to create an artificial or inflated price to be charged consumers. . . .[4]

This Court would be remiss in its duty if it did not cite the findings of the Commission, wherein it is said Mountain Fuel has been permitted to pay itself a profit for interdepartmental services. Heretofore, under Mountain Fuel's classification system, when an oil well has been developed and has been placed in the non-utility account, the non-utility account has been credited with the field price of the associated gas rather than the cost of service price. Under the amended purchase and sale agreement, there is a provision for Mountain Fuel to purchase, at market price rather than cost of service, the gas discovered on properties acquired by Wexpro, other than transferred

[3] *Florida Gas Transmission Company v. Federal Power Commission*, C.A. 5tn 1966, 362 F. 2d 331, 335-336, *Utah Power & Light Co. v. Public Service Commission*, 107 Utah 155, 192, 152 P.2d 542 (1944).

[4] *Cities Service Gas Company v. Federal Power Commission*, C.A. 10th 1969, 424 F.2d 411, 416.

acreage and that which comes to it under the joint exploration agreement. This provision violates the "no-profits-to-affiliates" rule.

There are certain factual aspects which must be reviewed in order to understand previous rulings of the Commission and the patent inconsistencies in the current order. We now address them.

Mountain Fuel has maintained a utility account # 105 in which has been held the unexplored or wildcat acreage. These assets have been deemed used and useful in the utility business by the Commission and have been included as capital assets in the rate base. As previously noted a utility is usually precluded from including in the rate base any capital asset, until it is developed, and then only to the extent the asset is used and useful in rendering the consumer service.

The determination of the Commission that this undeveloped acreage was used and useful in the utility business was consistent with statutory provisions. Under 54-2-1(30), the definition of a public utility includes a gas corporation, where the gas is sold or furnished to any consumer within this state for domestic, industrial or commercial use. Under 54-2-1(18), the definition of a gas corporation includes every corporation and person owning, controlling, operating or managing any gas plant for public service, within this state, or for the selling or furnishing of natural gas to any consumer or consumers within this state for domestic, commercial or industrial use. The key definition is the statutory one of gas plant.

54-2-1(17) provides:

> The term 'gas plant' includes all real estate and fixtures and personal property owned, controlled, operated or managed in connection with or to facilitate the production, generation, transmission, delivery or furnishing of gas (natural or manufactured) for light, heat, or power.

Under this broad definition, the undeveloped acreage may properly be deemed an asset of the gas plant, because it is owned to facilitate the production of gas.

As early as 1957, the Commission found funds for exploration and development were a just and reasonable expense as part of the utility function of Mountain Fuel. As a result the company maintained accounts # 795, # 796, # 797, # 798 as utility expense accounts. Covered under these direct exploration expenses were costs for lease maintenance (delayed rentals), non-productive well drilling (dry hole exploration), abandoned leases, and other authorized exploration expenses. Since 1960, $44,981,000 has been authorized by the Commission as a utility exploration expense, which has been reflected in the rates and charges for the sale of natural gas. Between 1966 and 1976, the utility expense account paid for 73.3 percent of dry hole exploration and the non-utility account paid 26.7 percent of this expense. The utility expense account paid 95 percent of the cancelled and delayed rentals on leases and the non-utility account paid 5 percent of this expense. Of the total exploration expenses for the ten year period, $37,250,000 was paid from the utility account, and $8,222,000 was paid by the non-utility account. It was not until 1972 that the Commission ordered the non-utility account to pay a portion of the exploration and development expenses; that year this account was ordered to bear $300,000 of the expense. In 1974, the non-utility account was ordered to pay 32.88 percent of this expense, and in 1975 the amount was increased to 50 percent.

Thus, as early as 1957, the traditional principles of utility law were modified by the Commission, e.g., generally the investor supplies the risk capital and sustains the losses in a speculative venture; the ratepayer only pays a return on that portion of the investment which is found used and useful in rendering the utility service. Although the exploration and development costs which were reflected in the rates and charges were characterized as a just and reasonable expense of the utility by the Commission, these charges were, in effect, a capital contribution to a speculative venture for the purpose of developing oil and gas sources. However, these charges can be justified under the broad statutory definition of a gas plant insofar as they are used to develop property owned, controlled, operated or managed by the gas corporation, to facilitate the production of gas.

What are the consequences to Mountain Fuel of the ratepayers being the primary source of the risk capital throughout the years? Mountain Fuel responds that the consumer benefits by being assured of a continuing supply of gas, at cost of service prices.

This response is insufficient, since under the statute the charges for exploration and development can be sustained only if they were utilized on property held as a utility asset, and the property remains classified as a utility asset after it is developed. This is so regardless of the nature of the hydrocarbons recovered. Mountain Fuel sustains a trust relationship to its customers, and it has a duty to conduct its operations in such a manner as to give to the consumers the most favorable rate reasonably possible. When the expenses to develop the utility properties were included in the rate base, the ratepayers were entitled to share in the benefit by having the net

profits on the oil, and other hydrocarbon substances, sold by Mountain Fuel to others, applied to reduce the cost of gas.[5]

Mountain Fuel, according to the findings, developed a system of classification based on custom or usage. This classification was never reduced to writing by either the utility or the Commission. If the exploration and development produced a successful well, it was classified as oil or gas based on the "value of production." This system involved measuring the product at the well head, or field separator facility, and then comparing the field price of gas and oil. Whichever substance had greater value determined whether the site was a gas or an oil well. Thus, any disparity between gas and oil prices at the time of classification could play a decisive role in determining whether it was a gas or an oil well. If it were a gas well, the drilling costs were capitalized and the well was held in a utility account, and any incidental gas and oil sales were credited to a utility account. If it were an oil well, the drilling costs were capitalized and held in the non-utility account; any associated gas was credited at field price to the non-utility account. In addition, any acreage logically related to the discovery was transferred and capitalized in the corresponding account.

There is another aspect of the classification system which requires explanation. The substances in the reservoir or at the surface may be in either a gaseous or liquid state. These substances are passed through a surface separator which separates the primary gases from the primary liquids. The primary liquids are referred to as "separator liquids" or "stock tank liquids." The primary gases are

[5] *Re Pacific Gas and Electric Company*, 97 P.U.R. 3d 321, 335 (1973).

referred to as "separator gas." The separator gas is then treated to remove what is commonly known as natural gas liquids; these are sold by the barrel at a price not regulated by the Commission. Gas is a hydrocarbon product, which under normal industrial standards is capable (after removal of contaminants) of being introduced into a natural gas transmission system and sold as distributor natural gas. Oil is all other hydrocarbon products, which are, under industry standards, normally introduced into a barrel or tank and sold in the market in such form. The Commission found these definitions had been employed by Mountain Fuel to separate utility products from non-utility, unregulated products. Mountain Fuel's definition was predicated upon the end use of the product and was not dependent upon the changeable or transitory nature of the effluent from its original state in the reservoir through the field separator.

The properties in the non-utility account, under this classification system, were the subject matter of the purchase and sale agreement. In its initial determination, the Commission limited the issue as to whether the properties in the non-utility account, which Mountain Fuel proposed to transfer to Wexpro, were properly held in this account under Mountain Fuel's system of classification. The Commission reasoned if they were non-utility properties under Mountain Fuel's classification, the Commission had no jurisdiction. The petitioners urged until there was an evidentiary hearing to determine whether, in fact, these properties were non-utility assets, there was an insufficient factual basis to determine the issue of the Commission's jurisdiction. We agree.

The classification of this property is of utmost importance, since this property is being transferred to

Wexpro at a depreciated book value of $33.1 million. The claimed gross revenue from this property for 1976 was approximately $39 million. An expert from Mountain Fuel estimated the fair market value of the property at $150 million. If, in fact, after a hearing the property should be classified as a utility asset, the ratepayers by this transfer, would be deprived of benefits to which they are entitled.

The net effect of the Commission's initial determination was that their jurisdiction was based on Mountain Fuel's classification. This classification, in turn, was based on the value of production; and whether the substance was deemed gas or oil was based upon the end use of the product. There is no statutory or legal basis to sustain such a classification.

The patent inconsistency in the position of the Commission is clearly revealed in their rulings and order concerning the amended purchase and sale agreement. The rationale to support the transfer was these assets were in the non-utility account, because they were not used and useful to Mountain Fuel in performing its utility function.

The order[6] permits the transfer to Wexpro of the non-utility oil properties and interests of Mountain Fuel as they existed on December 31, 1976. The Commission then ordered the gas in Brady-Weber formation, at blowdown, be reserved to Mountain Fuel. Mountain Fuel would reimburse Wexpro to the extent of the depreciated book value of wells utilized thereafter by Mountain Fuel to produce gas. Further, the gas reserves currently developed as utility wells at the Brady, Spearhead Ranch, Dry Piney and Birch Creek Fields were reserved to Mountain Fuel.

[6] Where reference is made to the order of the Commission, the language used in its description is largely drawn from the order itself. Such accounts for its somewhat obtuse and convoluted nature.

The order further provided Mountain Fuel should receive all of the natural gas from production which was currently available to its system, from the transferred properties, at cost of service. There was also a provision that Mountain Fuel would own all gas produced and sold from the transferred properties after January 1, 1977.

These provisions are tantamount to an evidentiary finding that these transferred "non-utility properties" were used and useful to Mountain Fuel in performing its utility function; therefore, they should be classified as utility properties.

Another interesting aspect of the order concerning the purchase and sale agreement is a provision that the income, costs and expenses, associated with the extraction of natural gas liquids from the gas stream by natural condensation, or further processing, after field separation, should be shared equally by Mountain Fuel and Wexpro. The effect of this order is to modify the definitions of gas and oil; yet the transfer to Wexpro of non-utility properties is sustained. The inconsistency arises because the product classification under which Mountain Fuel determined whether it should be included in the utility or non-utility account is modified. Yet the transfer of properties classified by Mountain Fuel's system is sustained.

The order further provided as to properties acquired by Wexpro, other than the transferred acreage, and those properties which would come to it under the joint exploration agreement, Mountain Fuel would have a right of first refusal to purchase gas at market price. Under the order concerning the joint exploration agreement, it is provided if an oil well is discovered, the well will be

capitalized in Wexpro's accounts, and Mountain Fuel shall pay Wexpro the cost of service price for the production of any associated gas.

A review of the provisions of the two agreements as modified by the Commission clearly indicates that, by the activities performed by Wexpro, it becomes a public utility subject to the jurisdiction and regulation of the Commission under Sec. 54-2-1(30).[7] Wexpro, by its joint activities with Mountain Fuel, particularly upon the transferred properties is both performing a service, viz., facilitating the production of natural gas, and delivering natural gas to its parent, both of which constitute Wexpro a public utility.

The Commission, in effect, recognized the utility functions performed by Wexpro by the provision in its order requiring Wexpro to cooperate in preparing the annual report and accounting of exploration and development activities, including expenses, capital costs, and revenues associated therewith on properties under, or affected by, the purchase and sale and joint exploration agreements.[8]

The order approving the amended purchase and sale agreement must be reversed, and there must be an evidentiary hearing. The Commission must reassess the

[7] The applicable provisions state:

> . . . when any person or corporation performs any service for or delivers any such commodity to any public utility herein defined, such person or corporation, and each thereof, is hereby declared to be a public utility and to be subject to the jurisdiction and regulations of the commission and to the provisions of this title . . .

[8] There is further posed the serious issue of whether it is in the public interest for Mountain Fuel to divide its utility function between itself and a subsidiary. Relevant factors to be considered in this inquiry include any potential administrative inconvenience caused by the necessity of regulating two corporate entities performing, in essence, a singular utility function; and additional costs and expenses affecting the rate base.

transfer and determine whether the properties were utility assets. The following is the criteria by which the properties should be classified:

(1) Was the property, while undeveloped, held in the utility capital account (Account # 105), upon which a rate of return was paid by the ratepayers?

(2) Were any funds from the utility exploration and development expense accounts (Accounts # 795, # 796, # 797, and # 798) applied to the development of the acreage?

(3) Has any natural gas or natural gas liquids been produced from the acreage?

If the answer *to any* of these is in the affirmative, the assets are utility property. Any transfer of a utility asset should be for fair market value so an appropriate benefit therefrom will redound to the credit of the ratepayers. Furthermore, before approving the transfer of a utility asset, the Commission should determine whether the transaction is detrimental to the ratepayer, and whether it is in the public interest.

The language of the Michigan Public Service Commission in *Re Michigan Consolidated Gas Company*[9] is particularly appropriate to explain the operative principles of this case. The Commission stated:

> Michigan Consolidated has for many years been engaged in an exploration program to discover gas producing fields. This commission has during this period allowed Michigan Consolidated to include gas exploration costs in its 'cost of service' as a legitimate part of its expenses properly chargeable to its utility customers.

[9] 78 P.U.R. 3d 321, 323-324 (1968).

In its exploration program, Michigan Consolidated did not deliberately set out to discover only oil or only gas fields. It secured leases and drilled wells where geological or geophysical service indicated some promise of either event. Thus, discovery of oil fields was not by design, but rather by accident and incidental to its gas exploration program.

Michigan Consolidated developed oil production in the Big Hand field in 1963 and discovered the Hardy Dam oil field in 1966. As is the case with most so-called oil fields, these reservoirs contain both oil and gas, and both flow or are pumped through the same wellbores to the surface where the oil and gas are separated. In these fields, the resultant oil is sold to refineries. Some of the gas is used for field purposes and the remainder is vented. Michigan Consolidated's management decided to treat these production facilities as nonjurisdictional and take the profits therefrom 'below the line' to inure to the benefit of its stockholders.

The record shows that the gas utility customers have already paid the exploration expenses leading to the development of these oil production properties through the cost of maintaining an active geological and reservoir engineering staff, obtaining leases, and drilling exploratory wells. Until these exploratory wells are drilled, it is not possible to determine whether the ultimate production from a particular lease will be oil or gas, or both. Moreover, Michigan Consolidated has charged some dry holes related to oil production to its gas operations, while venting gas produced with the oil. We also consider it significant that gas which has been vented from the wells producing oil in the Big Hand field will soon be gathered and ultimately utilized by Michigan Consolidated in serving its gas utility customers.

Consequently, we find that these oil

> production facilities cannot be considered as a separate non-utility operation, but are incidental to the natural gas exploration program and a part of Michigan Consolidated's gas utility operation. For these reasons, Michigan Consolidated's investment in these oil production facilities, as well as the revenues and expenses associated therewith, should and shall be treated and recorded as utility plant and utility operations for rate-making and accounting purposes.

In light of the potential loss of the properties transferred to Wexpro under the purchase and sale agreement, it is equitable that Wexpro be relieved of the obligations, if it so desires, it has undertaken in the joint exploration agreement. This latter agreement contains certain infirmities since its format follows Mountain Fuel's former system of classification of utility and non-utility properties, with the minor modification imposed by the Commission concerning natural gas liquids.

Under this agreement all acreage is held by Mountain Fuel, excepting oil producing acreage held by Wexpro. All exploration and development expenses up to $6,240,258 annually are shared equally by Mountain Fuel and Wexpro. If a gas well is discovered, Mountain Fuel pays for the costs and capitalizes it in the utility account in which it holds developed property. All oil from such a well is owned by Wexpro and obtained at cost of service of production. Acreage logically related to the well is capitalized in Mountain Fuel's utility account. The same terms apply to Wexpro, if an oil well is discovered. The classification of a well is based upon the value of production of each commodity for a thirty day test period. Mountain Fuel pays no drilling expenses on any acreage held by Wexpro. Wexpro pays fifty percent of the drilling expenses on acreage held by Mountain Fuel in its utility

plant in service account; if such a well is successfully completed it is classified as a gas or oil well in accordance with the agreement.

The joint exploration agreement, of course, does not identify the source of the exploration and development funds contributed by Mountain Fuel, viz., whether they are included in the rate base as an expense. Furthermore, the agreement does not reveal whether the account in which Mountain Fuel holds the undeveloped acreage is included in the rate base upon which a rate of return is permitted. Nevertheless, since exploration and development is a utility function to facilitate the production of gas, Mountain Fuel should receive all hydrocarbons produced to the extent of its proportional share of its contributions. Mountain Fuel's investments, revenues, and expenses arising out of the joint exploration agreement should be included in the appropriate utility accounts for rate-making purposes.

Finally, Mountain Fuel claims the adoption of any other system of classification of their assets (than the one they advance), would constitute a confiscation of property without due process of law. This claim is without merit. Mountain Fuel's classification was arbitrarily selected, without reference to the relevant statutory provisions previously cited in this opinion.

Mountain Fuel, in fact, would not be deprived of any property by a more realistic classification system; it would yet receive the receipts from the sale of oil. The classification of assets as utility or non-utility is strictly an accounting procedure, to reflect the reality of the situation, and no confiscatory aspect is involved. There are elements of fantasy involved in the claim that a utility asset, which has been held and developed as a utility

expense, undergoes a transfiguration into a non-utility asset by virtue of the value of the type of hydrocarbons recovered. To claim the "oil" operations consitute a separate business is a straw man to distract the unwary. If the assets involved, under the tests set forth in this opinion, be utility assets, they are subject to regulation.

> Where an activity or business is affected with the public interest, the courts have universally held that to subject such activity or business to regulation does not violate either the Fifth Amendment or the Fourteenth Amendment of the Federal Constitution. [Citations]. . .[10]

ELLETT, C.J.,* and CROCKETT and HALL, JJ., concur.

STEWART, J., does not participate herein.

WILKINS, Justice (dissenting):

I respectfully dissent.

I shall relate extensively my view of the nature of this case, as well as the facts, historical background, analysis of the issues, and law applicable thereto.

Petitioners appeal from the Final Report and Order on Rehearing of the Public Service Commission of Utah, dated April 11, 1978, in what has come to be known as the "Wexpro case." This final Order determined that the Commission's regulatory jurisdiction did not extend to

*Chief Justice Ellett had so acted in this case prior to his retirement; and also continues to participate at the request of the Court.

[10] *Natural Gas Service Co. v. Serve-Yu Cooperative, Inc.* 70 Ariz. 235, 219 P.2d 324, 329 (1950).

property transferred from Mountain Fuel Supply Company, a Utah corporation whose utility activities are regulated by the Public Service Commission, to Wexpro Company, Mountain Fuel's wholly owned subsidiary. The transferred property had been previously held in Mountain Fuel's "non-utility" accounts.[1] The Order also ruled that the Commission's regulatory jurisdiction did extend to the Joint Exploration Agreement (hereafter JEA) and the Agreement of Purchase and Sale (hereafter P&S) executed between Wexpro and Mountain Fuel to the extent that the Commission can regulate the sale of natural gas to a utility in this State, and that subject to the Agreements being amended as ordered by the Commission, they were in the public interest. The Order also reduced to writing and expressly approved a gas-oil classification, which, as discussed herein, is critical to the jurisdictional issue in the case.

Petitioners urge this Court to rule that the properties transferred to Wexpro are under the regulatory jurisdiction of the Commission, that the JEA and P&S are not in the public interest (since they adopt Mountain Fuel's gas-oil classification which defeats jurisdiction over the Wexpro properties), and that under the principle of "gain follows risk," the benefits arising from Wexpro's oil operation should be credited to Mountain Fuel's ratepayers. All statutory references are to Utah Code Annotated, 1953, as amended, unless otherwise specifically indicated.

In 1935, five small companies were merged to form Mountain Fuel. One of the companies produced oil, and

[1] "Non-utility accounts" or "non-utility operations" refer in this dissent only to Mountain Fuel's oil and related businesses. Mountain Fuel owns and operates other businesses not related to its gas and oil production.

its assets were categorized as non-utility and carried in accounts separate from the utility accounts which covered the four gas-producing companies. Mountain Fuel subsequently adopted and has consistently used the Uniform System of Accounts for Natural Gas Companies promulgated by the Federal Power Commission in 1940.

As Mountain Fuel's exploration and development program expanded, it discovered gas wells and oil wells and some wells which produced both. Although it discovered much more gas than oil it became necessary for Mountain Fuel to classify the wells which produced both as either gas or oil so it could assign them to the appropriate utility or non-utility account. Essentially gas was categorized as that hydrocarbon product which was capable, after contaminants and liquids were removed, of being placed in a natural gas pipeline for transmission and distribution. Oil was defined as all other hydrocarbon products which before or after treatment were, under industry standards, normally sold and transferred in a container or tank and delivered to a refinery.

Actually this definition applied only in mixed well classifications, which constituted a small percentage of the producing wells. For example, in the ten year period from 1966 to 1976, Mountain Fuel drilled 163 successful wells and only 22 contained both gas and oil. Of those, only one had as close a ratio between gas and oil production as 60 percent to 40 percent. The other 21 had ratios of over 70 percent to 30 percent for either gas or oil. This ratio was determined by examination of the hydrocarbon stream when processed in a separator at the well head. If the value of the natural gas in the well exceeded that of the oil, the

well was classified as a gas well. All associated expenses for drilling and completing the gas well were capitalized in the # 101 utility account. If the well was classified an oil producer, all associated expenses were capitalized in the # 121 non-utility account.

The Commission approved this accounting system, ruling it did not have jurisdiction over the non-utility accounts in June, 1948 (P.S.C. Case 3275), November, 1953 (P.S.C. Case 3972), February, 1957 (P.S.C. Case 4392), July, 1968 (P.S.C. Case 5907), and in February, 1972 (P.S.C. Case 6369). The classification system was challenged more vigorously in this decade, when the non-utility oil accounts became enormously valuable as a result of the Organization of Petroleum Exporting Countries' ("OPEC") oil management and pricing policies which had material impact in 1973 and following years.

Mountain Fuel's exploration and development program has also been under attack in this case. Through equity and debt financing and retained earnings, Mountain Fuel has raised investment capital to purchase or lease unexplored acreage. This acreage was held for future use in Mountain Fuel's # 105 utility account. Acreage in this account was treated as a capital cost, and Mountain Fuel's annual exploration and development expense, included in the rate base, was never used to finance its acquisition. The acreage in this # 105 utility account has been included in the rate base, as a capital asset, to the extent that consumers paid a rate of return to shareholders on their investment in that property.

From its formation, Mountain Fuel has maintained an aggressive and extensive exploration program.[2] It produces

[2]In its reserve system alone, which has 1.6 trillion cubic feet of natural gas, Mountain Fuel has added 615.9 billion cubic feet which are directly attributable to its own production.

over 30 percent of its entire system's requirements, one of the highest percentages in the United States. This gas comes to consumers at cost of service, or about $.40 per Mcf (thousand cubic feet), rather than market price, which averaged $1.17 per Mcf in 1977, or pipeline price, which in 1977 was $1.48 per Mcf. Petitioners do not dispute Mountain Fuel's testimony that its Utah customers pay the lowest, or among the lowest, rates of any gas utility customers in the country. To develop this low-cost gas and the reserves, the Commission has allowed Mountain Fuel to reflect as one of its operating costs, an exploration expense in its rate base. Like other costs in the rate base, this exploration and development expense was paid from general corporate resources, not a special, earmarked development fund. This exploration expense paid for such items as delay rentals on exploration acreage, abandoned leases, geophysical work, and non-productive well drilling, or dry holes. It did *not* pay for the initial lease or purchase acquisition, successful well drilling costs, completion costs, producing costs, costs to connect the well to a pipeline, or costs to construct and maintain pipelines. These latter costs, being capital costs, were borne by Mountain Fuel through equity and debt financing and retained earnings.

Exploration expense money was used to develop acreage held in the # 105 utility account. If exploration resulted in a gas discovery, the project costs to that point were not expensed or deducted in the year incurred, but were spread prospectively over the estimated well life after transfer to the utility # 101 account by capitalizing those costs and taking deductions for each year's depreciation and depletion. So, the costs of successful wells were never included in the money allotted as annual exploration and development expenses. It is the cost of lease maintenance,

geophysical work, and, most importantly, dry holes, included in the rate base, which is disputed here. The Commission heard conflicting testimony on whether or not the non-utility operations paid part of the exploration expenses prior to 1972. Mountain Fuel's exhibits, including certified audit reports, show that between 1960 and 1970 the non-utility operations had paid $430,544 for dry holes, or 3.2 percent of the total exploration expenses of the company. During that same period, the revenues attributable to the non-utility accounts constituted 3.1 percent of the total company revenues. Petitioners, on the other hand, maintain that prior to 1972 the non-utility accounts paid nothing toward expense for dry holes.

In 1972, the Commission reviewed the relationship between the utility and non-utility accounts and ordered the non-utility accounts to pay $300,000 of the annual exploration expense. In that year the non-utility operations of Mountain Fuel took on added significance with oil discoveries in Brady, Spearhead and Dry Piney Fields. Prior to 1972, the non-utility revenues were relatively minor in comparison to the natural gas revenues. In 1973, oil values increased markedly because of OPEC increases and the energy shortage. In 1974, after further review by the Commission, the non-utility operations were ordered to pay 32.88 percent of that part of the exploration and development cost which was expensed annually, while the utility accounts were to pay 67.12 percent. In 1975 the Commission ordered the utility and non-utility operations to share equally this cost.[3] Thus, while petitioners complain that from 1966 to 1976 the

[3] Under the Amended P&S and Amended JEA, Mountain Fuel and Wexpro share equally all expenses for dry holes drilled on acreage held by Mountain Fuel, and Wexpro pays all expenses for dry holes drilled on acreage transferred to it under the Amended P&S and JEA.

utility accounts paid 81.9 percent of the total annual exploration expense (including dry holes and other sub-categories) while the non-utility accounts paid 18.1 percent, it is also true that for the past three years the utility and non-utility accounts were ordered to pay equally. It is interesting to note, however, that the non-utility accounts actually paid *more* than the utility accounts during the past three years. Petitioners' own exhibit shows that from 1974 to the date of the Wexpro transfer (in 1976), the non-utility accounts contributed $6,600,000 to the dry hole expense while during that same period the utility accounts contributed only $4,245,000. No petitions for Commission rehearing or judicial review were taken from the 1972, 1974 or 1975 Orders claiming the Commission's allocations were unreasonable or unfair to the ratepayers. Further, petitioners did not in the Wexpro hearings, seek relief from the allocations made in those previous Orders, and of course, in my opinion, could not, even if relief had been sought, attack those allocations as a basis for their relief here.

In the 1973 and 1974 hearings, the Commission was urged to consolidate Mountain Fuel's non-utility and utility accounts for rate-making purposes. It finally did so in its January 14, 1974 Order on the basis that the oil and natural gas operations were inseparable from each other. Trading in Mountain Fuel's stock was suspended the following day to prevent what Mountain Fuel characterized as financial disaster. One week later the Commission entered an Order setting aside that part of the January 14 Order merging the non-utility and utility accounts. It did not, at that time, set aside its January 14 findings. The Commission also granted a petition for rehearing, and on July 18, 1974, entered a final Order

affirming the January 21, 1974 Order. This Order still did not reverse the January 14 findings, but it did hold that if the January 14 findings were inconsistent with any subsequent Order of the Commission, and specifically the July 18 Order, such subsequent Order would "take precedence and be controlling."

The Commission has continuing jurisdiction over public utilities, and it is not necessarily bound by its prior rulings or by rulings of Commissions in other states.[4] "Public interest" is a standard of public utility regulation, and since what is found to be in the "public interest" may change in different circumstances and under different facts, the Commission must always be free to regulate by law the utility to achieve results which benefit the public. Significantly, no petition for certiorari to this Court was taken asserting the inconsistency of the January 14, 1974 findings with the January 21 or July 18, 1974 Order,[5] and in the Final Order in the Wexpro case, the Commission found that

> for the purposes of Case 6668, [the January-July 1974 Hearings and Orders] the rationale of the January 14 order was impliedly if not expressly set aside and overturned . . . and in light of the foregoing Findings and Conclusions, the Commission concludes that the language of the January 14 Report and Order in Case No. 6668 with respect to the ratepayer risk, ratepayer rip-off and exploitation of MOUNTAIN FUEL customers is erroneous and should not stand as fact or law. All prior and subsequent Orders of the Commission

[4] 2 Davis, Administrative Law Treatise, § 17.07 at p. 530; *Mulcahy v. Public Service Commission*, 101 Utah 245, 117 P.2d 298 (1941); *accord Utah State Board of Regents v. Utah Public Service Commission*, Utah, 583 P.2d 609 (1978); 79 A.L.R. 2d 1131.

[5] This Court reversed the Commission's order in *Parowan Pumpers Association v. Public Service Commission*, Utah, 586 P.2d 407 (1978) for inconsistency between the order and the findings.

> reached an opposite conclusion based on a correct balancing of the interests of customers and shareholders of the company and this Commission herein affirms that long line of precedent.[6]

The Commission's explanation and conclusion in this Final Order in 1976 regarding the findings and orders in 1974, do not, I believe, infuse the right of appeal into these 1974 findings and orders. Nor do my comments in this dissent concerning continuing jurisdiction of the Commission lend themselves to an infusion. To decide otherwise would indeed violate rules of appellate review.

Regulatory jurisdiction over the non-utility operations has continued to be at issue in every Mountain Fuel rate case since 1974. This has resulted in substantial shareholder unrest as well as uncertainty in the capital markets. Early in 1976, some Mountain Fuel shareholders waged a proxy battle for control of the company, the central issue of which was the continued attack on the non-utility properties. The Commission in this case heard testimony that Mountain Fuel was unable to market a $20,000,000 common equity issuance of stock because of this uncertainty, and that Wexpro has also been unable to engage in capital financing. As long as Mountain Fuel remains a publicly held, capital intensive corporation, its financial capabilities are of extreme importance to the Commission. The evidence before the Commission disclosed that it is imperative that Mountain Fuel be able to finance its capital expenditures, for when the company falters, rates increase, utility services deteriorate, and the gas customer suffers. In short, the Commission found that a financially distressed utility benefits no one, least of all those who will have to depend on its services in the future.

[6] *Committee of Consumer Services, et al. v. Wexpro Co., et al.*, P.S.C. Case 76-057-14 at 3395-97 (1978).

To alleviate this regulatory uncertainty and to encourage successful re-entry into the capital markets, Mountain Fuel formed Wexpro, and it was for these reasons that the Commission found the Amended P&S and Amended JEA to be in the public interest.

The scope of this Court's review of the Wexpro proceedings should be governed by Sec. 54-7-16, and cases decided thereunder. This section provides for application for a writ of certiorari to determine the "lawfulness" of the order or decision of the Commission. It also states:

> . . . No new or additional evidence may be introduced in the Supreme Court, but the cause shall be heard on the record of the commission as certified by it. The review shall not be extended further than to determine whether the commission has regularly pursued its authority, including a determination of whether the order or decision under review violates any right of the petitioner under the Consititution of the United States or of the state of Utah. The findings and conclusions of the commission on questions of fact shall be final and shall not be subject ro review. Such questions of fact shall include ultimate facts and the findings and conclusions of the commission on reasonableness and discrimination.

Case law interpreting this statute is extensive and explicit. Of original importance is *Mulcahy v. Public Service Commission, supra,* wherein the Court wrote:

> In the language we used on the former application *Fuller-Toponce Truck Company v. Public Service Commission,* 99 Utah 28, 96 P.2d 722, 726): "Whatever may be our opinion as to whether the commission found well or wisely, or whether our conclusions on the evidence would have been the same, we are bound by the findings, when there is evidence to support them."

. . . . .

> What policy should be pursued, or what conclusions should be drawn from disputed facts is not a law question for the judiciary to decide. Such questions must be determined by the person or body whose action depends upon the determination thereof. But the question as to whether there is competent evidence to justify the action taken, or to be taken, is a legal question because the official body is authorized to act only according to law, that is, upon competent evidence. An attempt therefore to act upon a matter without any competent evidence to sustain it is not done according to law, and therefore is not done in the pursuit of lawful authority.
>
> . . . . .
>
> . . . It is not required that the facts found by the Commission be conclusively established, nor even that they be shown by a preponderance of the evidence. If there is in the record competent evidence from which a reasonable mind could believe or conclude that a certain fact existed, a finding of such fact finds jusitification in the evidence, and we can not disturb it. [Citations][7]

By far the most common test mandated in the cases is that there must be substantial, credible and competent evidence (hereafter, in this dissent, "evidence", used repeatedly, means "substantial, competent and credible" unless otherwise indicated) to support the decision of the Commission.[8] Although Sec. 54-7-16 states that the findings and conclusions are final and not subject to review this Court has authority to determine whether the Commission's findings were arbitrary or capricious, and

[7] 101 Utah at 265, 250, 249, 117 P.2d at 306, 300, 299.

[8] *Los Angeles & Salt Lake Railroad Co. v. Public Service Commission*, 121 Utah 209, 240 P.2d 493 (1952).

therefore contrary to law,[9] and can remand to the Commission when its Order is inconsistent with its findings.[10] This Court can review whether any constitutional rights of the complaining party have been invaded or disregarded and whether the Commission has exercised its authority pursuant to law.[11] Essentially, I believe, "scope of review" is the index to this Court's jurisdiction in this case.

Petitioners argue the Commission violated their rights to due process and procedural fairness, and they argue the Commission erred as a matter of law interpreting the statutes of this State to exclude Wexpro's property from its regulatory jurisdiction. Finally, they argue that the Commission erred in its determination that the Amended JEA and P&S were in the public interest because the Commission failed to adopt the principle advanced by them of "gain follows risk."

The central question here, I submit, is whether the Commission correctly ruled that it did not have jurisdiction over the Wexpro properties. This question is divided into two issues; first, whether the Commission correctly interpreted the jurisdictional statutes of our Public Utilities Code, and second, whether the Commission erred in adopting Mountain Fuel's gas and oil classification.

Petitioners' principal jurisdictional argument rests on a construction of Sec. 54-4-1, as modified by Subsection

[9] *Greyhound Lines, Inc. v. Public Service Commission*, Utah, 547 P.2d 199 (1976).

[10] Supra, note 5.

[11] *Salt Lake City v. Utah Light and Traction Company*, 52 Utah 210, 173 P. 556 (1918); *Terra Utilities, Inc. v. Public Service Commission*, Utah, 575 P.2d 1029 (1978).

(30) of Sec. 54-2-1. Sec. 54-4-1 states in broad terms:

> General Jurisdiction.—The commission is hereby vested with power and jurisdiction to supervise and regulate every public utility in this state, and *to supervise all of the business of every such public utility* in this state, and to do all things, whether herein specifically designated or in addition thereto, which are necessary or convenient in the exercise of such power and jurisdiction. [Emphasis added.]

Subsection 54-2-1(30) is a definitional section and provides in pertinent part:

> . . . Any corporation or person not engaged in business exclusively as a public utility as hereinbefore defined shall be governed by the provisions of this title in respect *only to the public utility or public utilities owned, controlled, operated or managed* by it or by him, and *not in respect to any other business or pursuit*. [Emphasis added.]

One statute seemingly vests jurisdiction, not simply over Mountain Fuel, but over all the businesses of Mountain Fuel, including Wexpro; however the second clearly limits Commission jurisdiction to Mountain Fuel's utility business. Petitioners urge that Sec. 54-2-1(30) should be read to exclude from the regulatory scheme only business "unrelated" to Mountain Fuel's utility activities. Since the Commission acknowledged that gas and oil may be discovered together, the argument continues, Mountain Fuel's oil properties are "related" to utility business activities and hence subject to regulation. Although petitioners contend their interpretation may be a reasonable one, it is not one, in my opinion, that the Legislature mandated, nor is it one this Court should feel empowered to impose judicially.

If it is reasonably possible to construe the statutes harmoniously, then we should not, of course, interpret discord between them. One reasonable reading of the statutes discloses no conflict between them. Both refer to the business of a "public utility." Sec. 54-4-1 must, by definition, relate to the *utility activities and business* subject to the regulatory jurisdiction of the Commission, and Sec. 54-2-1(30) simply reiterates the mandate to the Commission that it supervise the business of a *public utility*. But even if fatal tension is assumed to exist between the two statutes, rules of construction require that a definitional or specific section should govern over the general one.[12] Sec. 54-2-1(30) is definitional and specific, and it modifies the scope of Sec. 54-4-1 to confine the Commission's jurisdiction to the public utility business of Mountain Fuel.

Under either of these analyses concerning the two statutes, it remains the initial and basic responsiblity of the Commission to resolve factually, according to law, what is or is not a utility, and therefore to define what activities of the company are subject to regulation. In short, it is always within the purview of the Commission to examine the fact situation before it and determine whether its jurisdiction extends to that situation.

We note that the majority opinion does not comment on petitioners' interpretation of the jurisdictional statutes. Instead, it relies on what I perceive to be a forced analysis of Subsections 54-2-1(17), (18), and (30). Incidentally, this analysis was not argued before the Commission nor urged by the petitioners in their briefs on appeal.

[12] 2 A Sutherland, Statutory Construction, § 47.07 (1973); *Gallegos v. Midvale City*, 27 Utah 2d 27, 30, 492 P.2d 1335, 1337 (1972).

Subsection 54-2-1(30), which defines the term "public utility," contains the term "gas corporation." The majority opinion, concerning this Subsection states: "the definition of a public utility includes a *gas corporation*, where the gas is sold or furnished to any consumer in this state for domestic, industrial or commercial use." (Emphasis added.) It further comments that Subsection 54-2-1(18) defines the term "gas corporation" as every corporation and person owning, controlling, operating or managing any *gas plant* for public service. That opinion then quotes Subsection 54-2-1(17), which broadly defines "gas plant" as

> . . . all real estate and fixtures and personal property *owned*, controlled, operated or managed in connection with or *to facilitate the production*, generation, transmission, delivery or furnishing *of gas* (natural or manufactured) for light, heat, or power. [Emphasis added.]

It then determines that all undeveloped property which was held in the # 105 utility account is part of the gas plant since it was owned to facilitate the production of natural gas. And as part of the gas plant, the opinion continues, it was within a gas corporation, and as a gas corporation, it was a public utility. By this definitional chain, the majority opinion reasons that any and all property held in the # 105 utility account, including that property transferred to Wexpro under the Amended P&S and JEA, became and remained utility property. I disagree.

It seems to me that the reasoning of the majority opinion begs the vital question. Because the undeveloped property was initially placed in the # 105 utility account, the Court today assumes that we are compelled by Sec.

54-2-1(17) to conclude that that property became ". . . real estate . . . (which was) owned . . . to facilitate the production . . . of gas . . ." and hence was and is utility property. But that bare assertion rests, in the environs of this case, on no legal or factual authority.

Why? The record undeniably reveals that Mountain Fuel, with the approval of the Commission, segregated its non-utility oil properties from its utility accounts from the beginning, and these properties were always treated as non-utility in nature and excluded from the utility account, rate base, and rate of return. And the initial inclusion of these properties, along with gas properties—when all properties were undeveloped acreage—into the # 105 utility account should not vitiate this traditional segregation, which has had consistent Commission approval, and thereby transform *now* the utility and non-utility businesses into one estate. The irony of mandating, in effect, this merger is particularly striking, I believe, when the very policy and precedent which allowed a utility and non-utility classification greatly contributed to producing the lowest, or among the lowest, gas rates to the ratepayers of Mountain Fuel in this country, as well as producing significant natural gas reserves. In short the very format of historical classification that was established, and followed, produced an exploration and development program which eventuated in signal benefits to the ratepayers, Mountain Fuel, and the stockholders.

The majority opinion later determines from another paragraph of Sec. 54-2-1(30) that Wexpro itself is defined as a matter of law as a public utility, quoting that section as follows:

> . . . when any person or corporation performs any such service for or delivers any such commodity to

> any public utility hereindefined, such person or corporation, and each thereof, is hereby declared to be a public utility and to be subject to the jurisdiction and regulation of the commission and to the provisions of this title. . . .

and concluding that Wexpro, in aiding Mountain Fuel in discovery and production of natural gas becomes a utility. However, I find such as broad reading to deprive of meaning our whole statutory scheme of regulation. It is just as easily argued, under this interpretation, that federally regulated pipelines, though rarely used and not even owned by Mountain Fuel, would fall within the perimeters of the Commission's jurisdiction, as would privately owned wells which sell gas to Mountain Fuel, as well as the attorneys who represent Mountain Fuel in this appeal. Rather, I believe it necessary to read this segment of Subsection (30) of 54-2-1 in full context:

> *Except, as hereinafter provided,* when any person or corporation performs any such service for or delivers any such commodity to any public utility herein defined, such person or corporation, and each thereof, is hereby declared to be a public utility and to be subject to the jurisdiction and regulation of the commission and to the provisions of this title. *Any corporation or person not engaged in business exclusively as a public utility as hereinbefore defined shall be governed by the provisions of this title in respect only to the public utility or public utilities owned, controlled, operated or managed by it or by him, and not in respect to any other business or pursuit.* [Emphasis added.]

An interpretation of the definition of a public utility, I submit, must be made in the light of more than that determined by the majority opinion.

Much of the testimony in the Wexpro rehearing

consisted of definitions of gas and oil and was also taken to review Mountain Fuel's classification system. Gas-oil classification is critical to the jurisdictional issue and to petitioners' case, since what the Commission defines as non-utility (oil) is outside the scope of its regulatory jurisdiction. Petitioners argue, and this Court today concludes, that by adopting Mountain Fuel's gas-oil classification, the Commission abdicated its jurisdictional fact-finding role and allowed Mountain Fuel to determine the extent to which it is regulated and the scope of the Commission's jurisdiction over it. The answer to this argument is fundamental: the Commission, after reasonable inquiry and hearings on the relationship between Mountain Fuel's gas and oil operations, entered findings of fact and conclusions on the gas-oil classification, and so long as they are substantiated by evidence and law, as I believe they are, this Court should not overturn them on appeal if it adheres to proper and traditional rules of appellate review.

All petitioners assert error in the Commission's adoption of Mountain Fuel's classification system, though during the rehearing below the positions of Petitioner Division of Public Utilities and Petitioner Committee of Consumer Services differed significantly. The Committee of Consumer Services requested the Commission to take judicial and administrative notice of the oil and gas conservation statutes of Utah, Wyoming and Colorado and to fashion gas-oil definitions from them. Petitioner Division of Public Utilities did not submit to the Commission its own definition of gas and oil. It instead took the position that all hydrocarbons, regardless of their nature, produced by Mountain Fuel or Wexpro should be divided evenly between them; or as an alternative, that

Mountain Fuel should own all the natural gas and the natural gas liquids, and Wexpro should own the remaining hydrocarbons and the water collected from the separators on the wells.[13]

Mountain Fuel then introduced evidence on both its historic classification system, discussed previously in this dissent, and its proposed definitions of gas and oil.

Evidence was received and reviewed by the Commission on all of the proposals submitted by all of the parties. The Commission substantially ruled in favor of that classification system propounded by Mountain Fuel, and there is evidence, in my judgment, to support that determination. As long as there is evidence to support its decision, the Commission may choose among proposals. Simply because Mountain Fuel's evidence appeared the more convincing is no reason for this Court to now conclude that the Commission abdicated its regulatory responsibility and allowed Mountain Fuel to determine the scope of its jurisdiction.

The majority opinion cites *Re Michigan Consolidated Gas Co.*,[14] a case decided on somewhat similar facts, as directly contrary to the Commission's decision in Wexpro, and adopts it. One thing remains fatal to this Court's position: the Michigan Commission decided the case, choosing not to adopt the utility's evidence. Here, Utah's Commission found in accordance with the utility's evidence. In either case, so long as evidence exists to support the Commission's decision, that decision should

[13] The Commission noted in its findings that the Division's alternative proposal was followed by Mountain Fuel, except that distribution of the natural gas liquids was historically credited to the utility or non-utility accounts, depending on the classification of the well producing them.

[14] 78 Pub.U.Rep. 3d (PUR) 321 (Mich.Pub.Serv. Comm'n 1968).

stand from the point of view of factual determinations.

Petitioners must prevail on factual determinations, if at all, I believe, on the evidence produced at the Commission level, for this Court should not exceed *its* jurisdiction on review by directing that the Commission find and conclude against evidence sufficient to uphold its decision. The Commission retains continuing jurisdiction over Mountain Fuel's utility activities, and that company's utility business is always subject to Commission scrutiny. Further that scrutiny includes reasonable inquiry concerning whether non-utility activities are in fact non-utility.

It is a continuing legitimate concern that Mountain Fuel's primary management objective is the discharge of its public utility obligation. The Commission did not and could not, in my view, abdicate its jurisdiction, authority, or responsibility to protect the public interest in this matter. If there had been demonstrated by the evidence a reasonable basis for believing that Mountain Fuel's exploration or other business decisions were oriented to Wexpro's success at the expense of the public interest for which Mountain Fuel is certificated, the Commission had the authority, and the duty,[15] to take corrective action.

The Commission determined that while it did not have jurisdiction over the non-utility properties transferred by Mountain Fuel to Wexpro, it does have jurisdiction to review and approve contracts entered into by Mountain Fuel with respect to utility functions of the company and to disapprove the same in one or more parts if it finds any such utility contract to be unjust, unreasonable, or not in

[15] *See* Sec. 54-3-1 and 54-4-1.

the public interest. See Sec. 54-4-26,[16] which gives the Commission power to review contracts to which its regulated public utilities are parties. However, until the Commission, *not this Court,* is convinced by evidence of the correctness of a different classification system, the findings and conclusions of the Commission should be upheld.

Though the majority opinion does not address petitioners' contention that the Commission denied them due process and a full and fair hearing, I will do so. Their arguments, in essence, are first, that the Commission refused to expand the scope of the hearings beyond that required to determine whether it had jurisdiction over Wexpro until *during* the rehearing, and then decided issues beyond the scope of the rehearing; and second, that the Commission based its Order in Wexpro on evidence in other hearings.

Key to notions of fairness and due process is both notice and an opportunity to respond. Throughout the hearings and rehearings in this case, petitioners frequently moved the Commission to expand the scope of the hearings beyond that necessary to determine whether it had jurisdiction over the Wexpro transfer. In July, 1977, petitioners requested a hearing on several Wexpro issues

[16] Sec. 54-4-26

> Every public utility when ordered by the commission shall, . . . with respect to any other expenditures, submit such proposed contract, purchase or other expenditure to the commission for its approval; and, if the commission finds that any such proposed contract . . . is not proposed in good faith for the economic benefit of such public utility, the commission shall withhold its approval of such contract . . . and may order other contracts, purchases or expenditures in lieu thereof for the legitimate purposes and economic welfare of such public utility.

Accord, Sec. 54-4-4(2) and *Parowan Pumpers Association v. Public Service Commission, supra* note 5.

which the Commission subsequently granted in the General Rate Case (hereafter GRC) heard in August, 1977.

Having determined that it did not have jurisdiction over Wexpro in both its July 20 and August 29, 1977 Orders, the Commission granted rehearing to consider the P&S and JEA and Mountain Fuel's Amendments thereto, and to formulate a definition of gas and oil. At the beginning of the rehearing in September, 1977, the Commission in fact did expand the rehearing to allow every party to present its evidence on all issues relating to Wexpro. The rehearing, originally scheduled for two days, lasted eighteen days. Petitioners did not claim surprise, did not refuse to introduce testimony, and did not claim error in the Commission's ruling expanding the rehearing. Instead, each petitioner presented its case fully, called all its witnesses and introduced all the exhibits, plans and proposals it desired, and cross-examined the other witnesses. In closing arguments, petitioners argued the Commission should find on the issues raised by their evidence, reject the P&S and JEA and their Amendments, and require Mountain Fuel and Wexpro to execute contracts consistent with their versions of the evidence. They submitted orders for the Commission's signature consistent with their positions.

Now, on appeal, all claim error because the Commission decided issues beyond the scope of the hearing it originally ordered. Such claim, I believe, cannot stand. Sec. 54-7-1 provides in pertinent part:

> No informality in any hearing, investigation or proceeding, or in the manner of taking testimony, shall invalidate any order, decision, rule or regulation made, approved or confirmed by the commission.

Of course, if the informality or irregularities impair substantially the proceeding, they may well violate due process. Here, however, petitioners did not object to broadening the scope of the rehearing, and, indeed, accepted the opportunity to present their versions of the evidence. They argued persistently each and every fact they now appeal, concluding with a motion for further expansion of the rehearing on all the evidence. In connection with this last motion, Petitioner Division of Public Utilities indicated that substantially all of the evidence it intended to produce on the issues of classification and jurisdiction was, in fact, presented to the Commission during the Wexpro rehearing. Further, this petitioner's argument that it was deprived of due process of law is weakened by knowledge it gained as a result of its participation in outlining the procedure the Commission followed in its investigation of the Wexpro transfer and its audit of the transferred properties.[17]

Petitioners' second argument on their denial of due process concerns the Commission's reliance on evidence from the GRC in the Wexpro rehearing. In *Utah State Board of Regents v. Public Service Commission*,[18] the Commission had relied on evidence from a hearing over a year old involving different parties than those present in the case it was hearing, and this Court held therein that admission of this evidence was reversible error. Such is not the case here. At the request of Petitioner Committee of Consumer Services, testimony was taken for nine days in the GRC concerning the transfer of properties to Wexpro.

[17] Its audit concluded that the properties transferred to Wexpro were non-utility according to the utility-non-utility classification employed by Mountain Fuel.

[18] *Supra*, note 4.

Petitioner Committee announced that if Wexpro testimony was taken in the GRC, it would not have to be taken again in the Wexpro rehearing. The Commission stated, and made it clear in both the Wexpro hearings and the GRC, that it was taking testimony in the GRC for both cases. Petitioners designated for the record in the Wexpro rehearing and for this petition for certiorari portions of the GRC testimony. All petitioners were present and were parties in the GRC, and, importantly, no petitioner expressed dissent when the Commission announced it would take evidence in the GRC concerning Wexpro. Petitioners had notice that GRC testimony would be used in the Wexpro rehearing, and they had an opportunity to respond in both hearings. Hence, no deprivation of due process occurred.

This Court, in the majority opinion, expresses alarm at the transfer of Mountain Fuel's non-utility property to Wexpro at depreciated rather than fair market value, as the issue of whether this property is utility or not was not properly determined by the Commission. I disagree. The Commission heard evidence on all aspects of the transfer and found that this property was non-utility on that evidence and applicable law. As non-utility property, its transfer was outside the Commission's jurisdiction.

What alarms me, inter alia, is that the Court today has actually determined, I believe, that the transferred property is utility property, notwithstanding its decision to remand this case for an evidentiary hearing at which criteria for classification, in the form of three questions are to be employed. Just a facial reading of the majority opinion with these listed criteria and the undisputed evidence in this case convince me that the Court has determined today, without further hearing, that the

subject property is utility. Why then, I ask, even though I think the Court is in error, prolong the judicial process by requiring that further hearing.

I now address what the majority opinion determines to be three basic principles of utility law, and upon which it bases its findings and views. These principles are: first, that public utilities sustain a trust relationship to their ratepayers; second, that risk capital for utility development is provided by investors in the utility and that property is included in the rate base to the extent that it is used and useful; and third, that any amount paid to a company as a profit by a utility which controls that company cannot be included as a charge in the rate base (the "no profits to affiliates" rule). I disagree with these principles or the majority's application of them to this case.

First, I find no statutory authority in this State's Public Utility Code, or any case law in Utah supporting the proposition that the relationship between a public utility and its ratepayers is fiduciary or one of trust. As a regulated monopoly, a public utility may not do business in the same manner as it could were it not regulated. Sec. 54-4-2[19] imposes on the Public Service Commission the standard of regulating public utilities in a reasonable manner consistent with the public interest. If a public

[19]Sec. 54-4-2. Whenever the commission believes that in order to secure a compliance with the provisions of this title or with the orders of the commission, or that it will be otherwise in the interest of the public, an investigation should be made of any act or omission to act, or of anything accomplished or proposed, or of any schedule, classification, rate, price, charge, fare, toll, rental, rule, regulation, service or facility of any public utility, it shall investigate the same upon its own motion, and may fix a time and place for a hearing thereof with notice to the public utility concerning which such investigation shall be made, and upon such hearing shall make such findings and orders as shall be just and reasonable with respect to any such matter.

utility conforms its practices to the public interest, neither the Commission nor this Court have cause for misgivings. The term "public interest", however, encompasses more than protection of the class of ratepayers at the expense of all others, contrary to what I believe to be the implication of the majority opinion. It necessitates balancing the interests of the utility's ratepayers, its shareholders and the public itself within the utility's area of service. Until the Legislature amends the statutes to provide for a trust or fiduciary responsibility from the utility to its ratepayers, this Court, I believe, should adhere to those statutory mandates now in force as the Commission below has done.

Second, I have no quarrel with the observation made in the majority opinion that utility shareholders provide risk capital. I address the majority's *use* of that principle *infra* in this dissent. But here, I comment on references in the majority opinion to facilities (undeveloped acreage) which are used and useful to the consumer as includable assets in the rate base for reasons now noted. Traditionally, this undeveloped acreage in this case was included in the rate base. But the majority opinion weaves that fact into an argument that this inclusion was justified under a broad definition of a gas plant in Sec. 54-2-1(17), discussed *ante*, and makes the oil properties utility properties.

The argument eludes me. Rather than concluding, as does the majority opinion, that ". . . traditional principles of utility law were modified . . ." by the Commission in permitting this inclusion, but that Sec. 54-2-1(17) justifies this modification, I find another analysis to be legally sounder. It may be, *arguendo*, that a rate of return should not traditionally have been allowed on this acreage, but the question of placing the undeveloped acreage in the # 105 utility account, and the Commission's allowance

thereof, was not addressed, argued or appealed to this Court at the times the acreage was placed in that account, nor in the petition for certiorari in this case. So that question is not before us. And that error, if any particularly in view of all of the evidence in this case, does not, in some self-propelling manner convert unregulated oil into a regulated category under the Commission.

Third, I think the "no profits to affiliates" rule has no application to the facts of this case. The cases cited by the majority opinion,[20] concerning profits paid to affiliated construction companies formed by their parent utilities and rights to purchase gas at cost of service reserved in a contract which was regulated by the Federal Power Commission, describe the basic tenets of this rule. Arising under federal regulatory law and cited mostly in federal cases, it has been invoked where a "dummy" corporation is formed as an affiliate to perform services for the utility (a) where the affiliate has no assets or capital of its own, or (b) where the profits paid to the affiliate were fictitious, fraudulent or collusive. The affiliate susceptible to this rule may be so dependent upon the utility that it has no legitimate business existence of its own. The rule has not been interpreted in the cases cited by the majority opinion to disallow all profits paid to affiliated companies. It is a rule narrow is scope, and Courts have cautioned against its expansion.[21]

Cities Service Gas,[22] is easily distinguishable from the

[20] *Florida Gas Transmission Company v. Federal Power Commission*, 362 F.2d 331 (5th Cir. 1966); *Utah Power & Light Co. v. Public Service Commission*, 107 Utah 155, 152 P.2d 542 (1944); *Cities Service Gas Company v. Federal Power Commission*, 424 F.2d 411 (10th Cir. 1969), cert. denied, 400 U.S. 801, 91 S.Ct. 9, 27 L. Ed.2d 33 (1970).

[21] *Florida Gas Transmission Company*, 362 F.2d at 336, 337.

[22] *Supra*, note 20.

instant case. There the pipeline utility spun-off to an affiliate its utility owned and federally regulated property from which it purchased gas at cost of service. The transferred property was not non-utility, unregulated oil producing property as in the case here. When the affiliate transferred the property to a non-affiliated company, reaping a $21 million profit to the parent, the United States Court of Appeals for the Tenth Circuit, although discussing the "no profits to affiliates" rule, affirmed the Federal Power Commission's ruling to price the purchased gas at cost of service rather than the contract amount on the basis that the cost of service rate had been reserved in the Federal Power Commission's grant of the original certificate to the affiliate, which reservation could not be dissipated by alienation to a non-affiliated third party.[23]

In the *Utah Power & Light* case,[24] Mr. Justice Wolfe concluded for this Court that the utility's wholly owned subsidiary, a "dummy" corporation with no assets or capital of its own, was doing construction work for the parent-utility with the parent's assets, and that in such a relationship there was "no reasonable basis as far as rate making is concerned upon which it could be paid more than actual costs."[25]

Such is not the case here. The evidence in this case discloses that Wexpro is adequately capitalized and, in my judgment, owns substantial assets. Its oil production constitutes a legitimate business objective independent of the utility-parent's, Mountain Fuel's, objectives, and it is

[23] 424 F.2d at 417.

[24] *Supra*, note 20.

[25] 107 Utah at 193, 152 P.2d at 559.

not formed for, or involved in, the construction of a capital asset for its parent.

Florida Gas[26] is no authority for the majority's position. Indeed, the Fifth Circuit, on remand to the Federal Power Commission, disallowed application of the "no profits to affiliates" rule. In that case, four engineering and construction firms were formed from the sale of 37.5 percent of the utility's stock, and neither the utility nor the four-company group controlled the other. The Federal Power Commission relying on federal regulations and opinions not applicable to this case, and Section 10 of the Clayton Act,[27] disallowed, as part of the utility's cost of service, the profits paid to the four company group. The United States Court of Appeals for the Fifth Circuit reversed the Commission because the profits paid were actual, legitimate costs, with no fraud, collusion or fiction involved in their payment, and remanded the case to the Federal Power Commission to determine whether the profits were reasonable without applying the "no profits to affiliates" rule.

In this case, none of the parties had the opportunity to address this rule below or here. Further, petitioners, after a six-month investigation and audit of Wexpro, raised no claims of fictitious, fraudulent or collusively paid profits, and do not raise such a claim here in their petition or in their briefs.

The majority opinion today heralds an unforunate principle by applying the "no profits to affiliates" rule to this case, I believe. In so doing, it ignores the criteria outlined in the cases it cites as authority, and, further,

[26] *Supra*, note 20.

[27] 15 U.S.C. § 20 (1976).

erroneously assumes (1) that Wexpro is a utility and holds utility property, and (2) that the relationship between Mountain Fuel's utility accounts and Wexpro is so close that acts conducted between them are tantamount to a single intracompany business.

Petitioners attack the Commission's findings and conclusions that the Amended JEA and Amended P & S were in the public interest. They assert error in the Commission's failure to adopt their principle of "gain follows risk," which, as set forth in *Democratic Central Committee v. Washington Transit Commission*,[28] a case on which petitioners heavily rely allocates gains on capital between shareholders and ratepayers under equitable principles. This Court, I believe, espouses the essential principle of this case without discussing it, which I shall now do. It states:

> One [Equitable principle] is the principle that the right to capital gains on utility assets is tied to the risk of capital losses. The other is the principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom. The justice inherent in these principles is self-evident.
>
> . . . . .
>
> The allocative process, we have said, necessitates a delicate balancing of the interests of investors and consumers in light of the governing equitable principles. The constant effort must be a distribution of the gains as fairness and justice may require. . . . Consumers become entitled to capital gains on operating utility assets when they have discharged the burden of preserving the financial integrity of the stake which investors have in such assets. . . .

[28] 158 U.S. App. D.C. 107, 485 F.2d 786 (1973), *cert. denied*, 415 U.S. 935, 94 S.Ct. 1451, 39 L.Ed.2d 493 (1974).

> And in appraising the equities, neither administrative nor judicial tribunals are at liberty to ignore economic reality.[29]

Petitioners argue that by inclusion of part of the costs of the exploration and development program in the rate base, the ratepayers have assumed the risks of the non-utility operations, and hence should reap the benefits of these non-utility revenues in decreased gas rates. Prior to 1972, the Commission allowed Mountain Fuel to charge against its utility rates most of its exploration costs where the drilling was unsuccessful, but, as the evidence discloses, this same exploration program resulted in development of significant gas reserves and sales to Mountain Fuel's consumers at rates far below those it would have to charge if it had no exploration program and purchased its gas from other producers.

Petitioners have convinced this Court to treat that part of this expense as a contribution to capital, i.e., an investment, by the ratepayers in the oil and gas properties of Mountain Fuel and Wexpro. The majority opinion states:

> Although the exploration and development costs, which were reflected in the rates and charges were characterized as a just and reasonable expense of the utility by the Commission, these charges were, in effect, a capital contribution to a speculative venture for the purpose of developing oil and gas sources.

and, quoting from Commissioner Rigtrup's dissent,

> However, it appears that the shareholders of Mountain Fuel have come to expect an unregulated return from oil properties, for which the risk capital

[29] *Id* at 806, 821.

> was largely derived in rates charged its customers as ordered by the Commission. . . .

Such statements evince a disregard for basic accounting principles, i.e., the distinction between expense and capital expenditures. Mountain Fuel, through money supplied by its investors, not its ratepayers, acquired the property it explores and develops for hydrocarbon production. This property is a capital asset, and Mountain Fuel incurred a capital, investment risk when it acquired it. Money used to explore the property, up to that point where the type of hydrocarbon production from the property is ascertained, was expense money. Part of it was acquired from the ratepayers through monies received by them in payment of their gas bills as was part of the other operating expenses of Mountain Fuel. Money which is spent for expenses is usually deducted, for tax purposes, in the year it is spent, and it is treated entirely differently than money spent to capitalize an asset. Certainly its expenditure constitutes no investment or capital risk. Simply, the ratepayer is not assuming an ***investment*** risk. The risk the ratepayer assumes because the Commission permits Mountain Fuel the expense is the risk that exploration will prove more costly than purchases from other producers. The ratepayer's reward for assuming such risk is that the savings Mountain Fuel realizes from finding its own gas must pass through to that ratepayer.

The record in this case shows that Mountain Fuel's oil has always been treated as the source of reward for those who take ***investment*** risk, whose money is used for acquisition of both oil prospects and gas prospects, and whose investment may evanesce if Mountain Fuel cannot remain competitive. The record also shows that cost savings attributable to Mountain Fuel's gas exploration

program have been substantial and have passed to ratepayers. I cannot see how prospects for that kind of benefit to Mountain Fuel's customers can be enhanced by removing incentives for investors to supply capital for Mountain Fuel's lease acquisitions and oil-oriented drilling.

Democratic Central Committee,[30] which established the principle of "gain follows risk," arose from a unique fact situation and is not applicable to this case. The property disposed of in *Democratic Central Committee* had already been determined to be utility property. Such is not the case here. In that case, the District of Columbia Transit Company acquired all the stock of Capital Transit Company at approximately one-half its value. Only $500,000 of the $13.5 million acquisition cost had been paid by the investors; the balance was paid by the utility operations. In Wexpro, capital acquisition was and is undertaken by the shareholders. Successful wells were capitalized in the appropriate accounts, and the utility rates do not reflect these expenditures. In *Democratic Central Committee,* the share holders paid themselves an average of 83 percent each year on their investment, sold the company's real property, and finally sold the company's worn-out rolling stock to a new transit company. The Court ordered that the profits from the sale of both the depreciable property (the rolling stock) and the non-depreciable property (the real estate) should be treated as utility income. Mr. Justice McKinnon concurred that the profits of the sale to the extent of the accumulated depreciation should inure to the ratepayers' benefit, but strongly dissented as to the profits from the sale of the

[30] *Id.*

non-depreciated real property by writing:

> . . . Outside the District, there is a paucity of cases and the few that are cited cannot directly support the action taken here. [Citations] The majority observes the dearth of decided cases and seems to take this as a "license" to deal with the question as if writing on a clean slate. It would appear, however, that the lack of cases in point is probably more indicative of the fact that no one previously has ever imagined of or argued for such a novel approach with respect to nondepreciable assets.[31]

The Commission refused to adopt *Democratic Central Committe,* and instead found this language from *Board of Public Utility Commissioners v. New York Telephone Company* [32] applicable by citing it in Finding 37: [33]

> The customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary. [Citations] The revenue paid by the customers for service belongs to the company. The amount, if any, remaining after paying taxes and operating expenses including the expense of depreciation is the company's compensation for the use of its property. * * *
>
> Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.

[31] *Id,* at 834.

[32] 271 U.S. 23, 46 S.Ct. 363, 70 L.Ed. 808 (1926).

[33] *Supra,* note 6 at 3394.

> Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock.[34]

New York Telephone has been cited many times in recent years as standing for the proposition that customers of a utility pay for service, not for the utility's property, and I find this case to be foundationally strong, sound, and traditional. That part of its holding allowing valuation of utility assets at current market value, no longer followed today, is not germane either to the finding or the logic of that part of the case relied upon by the Commission. The Commission correctly ruled against petitioners when it refused to adopt or apply the principles of gain follows risk, and I believe the majority opinion errs when it adopts those principles.

I also feel constrained to discuss what I believe is the most serious consequence of the majority opinion: a taking of private property *by this Court* without due process of law. Although it remands this case to the Commission for an evidentiary hearing on whether the transferred properties are utility, the majority opinion on at least five occasions (as discussed *supra* in this opinion) in fact determines, in its guidelines to the Commission, that the properties are utility: Under its definitional chain involving Subsection 54-2-1(17), (18), and (30), the undeveloped properties in the # 105 utility account are deemed utility property. Another sentence in Sec. 54-2-1(30), quoted in footnote 7 of the majority opinion, is interpreted to "clearly indicate" that Wexpro, by its activities, is a public utility. And finally, in its instructions for remand, the majority opinion specifies three criteria, any one of which, if met, confer utility status on Wexpro's

[34] *Supra*, note 32 at 31, 32.

property. We have discussed these three criteria, *ante*, which appear in the form of questions, noting not only that answers thereto already were found as fact by the Commission below on rehearing but that they were discussed and determined by the majority opinion on appeal, making the whole remand for their resolution demonstrably needless. In this case, it is this Court, not the Commission, which will be responsible for the appropriation of Wexpro's assets "to the appropriate utility accounts for rate-making purposes." And this Court appropriates those assets on the basis of arguments neither party had a chance to address before the Commission or in their briefs here.[35]

The majority opinion states that regulation of utility property is not a taking. With that proposition generally I do not argue, but I do believe this Court ought not to conclude that property which is and always has been treated as private property becomes utility property, in order to appropriate its revenues to the public use, and all in the name of mere regulation of utility property. That opinion relies on *Natural Gas Service Co. v. Serve-Yu Cooperative, Inc.*,[36] a 1950 case from Arizona, to support its decision to confiscate Wexpro's oil revenues and apply them to the rate base as not violative of due process. In the twenty-nine years since it was decided, that case has never been cited in another case as supportive of the proposition for which the majority quotes it. Instead, I find the language of Article I, Section 22 of the Constitution of this

[35] This Court has generally held that where the parties have not raised an issue either below or in their briefs on appeal, the Court should not volunteer the issue or dispose of the case on that issue. See *Thomas v. District Court*, 110 Utah 245, 171 P.2d 667 (1946).

[36] 70 Ariz. 235, 219, P.2d 324 (1950).

State, and the Fifth and Fourteeneth Amendments to the United States Constitution more compelling. Utah Const., Art. I, Section 22 states: "Private property shall not be taken or damaged for public use without just compensation." It is somewhat broader in scope than the Fifth Amendment to the United States Constitution in that it provides for compensation for *damage* to private property.

It is settled that public utilities may perform services in private capacities, and in doing so are subject to the same rules and rights as a private person.[37] And as corporations, of course, they also have rights to due process.[38] I find evidence to support the Commission's determination that the properties transferred to Wexpro were non-utility. To roll into the rate base revenues from the oil property beyond the amount computed as a regulated rate of return is nothing short of a massive appropriation of the property right of Mountain Fuel's shareholders. This Court has long recognized, as well as have the federal courts,[39] that when private property is forced into the public's service, a taking has occurred. In *Stockdale v. Rio Grande W. R.R. Co.*,[40] this Court stated:

> And the great weight of judicial authority, which we believe to be supported by the better reason,

[37] *Floyd & Co. v. Cincinnati Gas & Electric*, 96 Ohio App. 133, 120 N.E. 2d 596 (1954); 64 Am.Jur.2d Public Utilities § 1; 73 C.J.S. Public Utilities § 9.

[38] *Olympic Forest Products, Inc. v. Chaussee Corporation*, 82 Wash. 2d 418, 511 P.2d 1002 (1973); *Grosjean v. American Press Co.*, 297 U.S. 233 56 S.Ct. 444, 80 L.Ed. 660 (1936).

[39] *United States v. Causley*, 328 U.S. 256, 261, 262, 264-267 (1946); *See Republic Natural Gas Co. v. Baker*, 197 F.2d 647 (10th Cir. 1952). "The law does not imply a power in the regulatory bodies or the courts to take the property of one party and give it to another in order to effectuate a just result." *Id* at 650.

[40] 28 Utah 201, 211, 77 P. 849, 852 (1904).

> and which is more in accord with our ideas of equity and natural justice, holds that any substantial interference with private property which destroys or materially lessens its value, or by which the owner's right to its use and enjoyment is in any substantial degree abridge or destroyed, is, in fact and in law, a taking, in the constitutional sense, to the extent of the damages suffered, even though the title and possession of the owner remain undisturbed.

and reiterated the principle the following year in *Oregon Short Line R.R. Co. v. Jones:*[41]

> In earlier times it was held that property could be deemed to be taken, within the meaning of constitutional provisions, only when the owner was wholly deprived of its possession, use, and occupation. But a more liberal doctrine has long been established and an actual, physical taking of property is not necessary to entitle its owner to compensation. A man's property may be taken, within the meaning of constitutional provision such as ours, although his title and possession remain undisturbed. To deprive him of the ordinary beneficial use and enjoyment of his property is, in law, equivalent to the taking of it, and is as much a taking as though the property itself were actually taken. Authorities to this effect are numerous, and this principle of law has become embodied in many Consititutions (taken or damaged) and in many statutes. It is so with respect to our own. [Citations]

And finally, in 1974, this Court interpreted Article I, Sec. 22 of Utah's Constitution as it applied to "damaging" property in *Utah State Road Commission v. Miya:*[42]

[41] 29 Utah 147, 153, 80 P.732, 734 (1905).

[42] Utah, 526 P.2d 926, 928 (1974).

> However, where a police power is exercised as an incidental result of the exercise of eminent domain, just compensation is due if the market value of the property has been diminished. *The constitutional guarantee of just compensation for the taking or damaging of private property for public use is in no way affected by the fact that the expropriator is exercising the police power.* [Emphasis added.]

The taking of Wexpro's property cannot be justified by the euphemism of "regulation" under the Legislature's police power.

Investor owned public utilities are subject to the regulatory jurisdiction of the Public Service Commission only in regard to their utility property, their rates and their service in Utah. But regulation does not talismanically convert these utilities into ownership by the public. The law's highest function is to remain keenly sensitive to the preservation of all fundamental rights, which include, of course, private property rights.

Together with the Constitutional issue just discussed, I believe that the crucial primary considerations here, by this Court, which must recurrently acknowledge its own limitation of power in appellate review of administrative action, should be whether (1) the findings as a whole are supported by substantial, credible, and competent evidence, (2) the findings, conclusions and final Order are not contrary to law, and (3) the Commission acted without arbitrariness and caprice. It is my view this Court should have resolved these matters here in support of upholding the Commission's determination and concluded that these determinations were consonant with the public interest.

I would affirm the Order of the Commission.

SUPREME COURT OF UTAH
STATE OF UTAH
July 18, 1979
No. 15835

Office of the Clerk
Committee of Consumer Services; Utah Department of Business Regulation, Division of Public Utilities; and Salt Lake County,

Plaintiffs,

v.

Public Service Commission of Utah; Milly O. Bernard, Chairman; Olof E. Zundel, Commissioner; and Kenneth Rigtrup, Commissioner,

Defendants,

Mountain Fuel Supply Company, a Utah corporation; Wexpro Company, a Utah corporation; and Alex Oblad, Harold Burton, and Carlyle Harmon, Mountain Fuel Shareholders,

Intervenors and Respondents.

This day petition for rehearing denied.

/s/ Geoffrey J. Butler, Clerk

APPENDIX B

Before the Public Service Commission of Utah

In the Matter of the Petition
of the Division of Public
Utilities to consider the
proposed transfer of certain
wells, leases, lands, and
related facilities and
interests of MOUNTAIN FUEL
SUPPLY COMPANY TO
WEXPRO COMPANY.

Case No. 76-057-14

REPORT AND ORDER
ON REHEARING

BEFORE THE PUBLIC SERVICE COMMISSION
OF UTAH

In the Matter of the Petition
of the Division of Public
Utilities to consider the
proposed transfer of certain
wells, leases, lands, and
related facilities and
interests of MOUNTAIN FUEL
SUPPLY COMPANY TO
WEXPRO COMPANY.

REPORT AND ORDER
ON REHEARING

Case No. 76-057-14

Appearances:

G. Blaine Davis Assistant Attorney General	For	Division of Public Utilities, Department of Business Regulations State of Utah
Stephen R. Randle Assistant Attorney General	"	"
Daniel L. Berman Special Assistant Attorney General	"	"

Robert S. Campbell, Jr. Attorney-at-Law	"	Mountain Fuel Supply Company
R. G. Groussman Attorney-at-Law	"	"
Marcus G. Theodore Deputy Salt Lake County Attorney	"	Salt Lake County
James L. Barker, Jr. Assistant Attorney General	"	Committee of Con- sumer Services
Calvin L. Rampton Attorney-at-Law	"	Wexpro Company
Edward W. Clyde Attorney-at-Law	"	Individual Mountain Fuel Shareholders

---

By the Commission:

INTRODUCTION

This matter came on regularly for Rehearing before the Commission on Monday, September 12, 1977, at the Hearing Room of the Commission, 330 East Fourth South, Salt Lake City, Utah, pursuant to and in accordance with the ordering Paragraphs C and D of the Commission Order under date of August 29, 1977, which provided:

> "C. IT IS FURTHER ORDERED that, based upon its own motion, and to the limited extent that the various petitions seek a review of the Mountain Fuel-Wexpro agreements, the Commis-

sion orders Mountain Fuel to present the specific amendments to the Mountain Fuel-Wexpro agreements which it generally discussed at the August 23, 1977, hearing. Such specific proposal shall be the subject of an evidentiary hearing to be held on the matter, which hearing shall be limited solely to the consideration of such proposal. All parties will be allowed cross examination and direct testimony thereto.

"D. IT IS FURTHER ORDERED, that a public hearing be held at 10:00 a.m. on Monday, September 12, 1977, at the Commission's hearing room, 330 East Fourth South, Salt Lake City, Utah, for the sole purpose of receiving evidence and hearing arguments concerning the specific amendment of the Mountain Fuel-Wexpro agreements as generally described by Mountain Fuel in the August 23, 1977 hearing, with the definition of oil and gas to be adopted by this Commission. A decision thereon will be reached by the Commission not later than three (3) days thereafter."

Notice was duly and properly given of the September 12, 1977, hearing. Appearances were taken, the issues of fact and law were defined, extended argument was advanced by all parties with respect thereto, and the Commission thereupon proceeded to hear the testimony and evidence. Witnesses were called and underwent examination in behalf of Mountain Fuel Supply Company and the Division of Public Utilities, motions were made by the Division, the Committee of Consumer Services and Salt Lake County during the course of the hearings, extended argument was taken during the evidential phase of the proceedings and broad latitude was accorded all parties in the proffer of evidence and the submission of argument on the issues of law and fact framed in the hearing, as well as that raised on motion. The rehearings continued during the days of September 12, 13, 14, 15, 19, 20, 21, 22, 23,

26, 27, 28, 29, 30, October 3, 4, 5, and 7, the latter day of which was devoted to closing summation by respective counsel for the parties, whereupon the case was taken under advisement by the Commission for deliberation on all questions of fact and law framed by the issues and raised by the motions of the parties.

The testimony, evidence and exhibits of the parties produced at the hearings as well as that received by the Commission bearing upon the Mountain Fuel-Wexpro transfer and the Joint Exploration Agreement in P.S.C. Case No. 77-057-03 (II) along with the argument of counsel having now been fully reviewed and considered and the Commission being apprised as to all and singular the law and facts appertaining in the matter, and having on Friday, the 28th day of October, 1977, issued its oral Decision and Order in the Case and having now determined that such Decision and Order should be reduced to written Findings of Fact, Conclusions and a Report and Order on Rehearing,

NOW, THEREFORE, the Commission, for good cause shown, herewith enters its Findings of Fact, and Conclusions of Law as follows, to-wit:

FINDINGS OF FACT AND CONCLUSIONS

1. This phase of the Case was set down on rehearing pursuant to and in accordance with the Report and Order of the 29th day of August, 1977 to further consider issues affecting the relationship of Mountain Fuel Supply Company (hereinafter MOUNTAIN FUEL) and its subsidiary corporation, Wexpro Company (hereinafter WEXPRO). As in all other hearings conducted in this Case, due and proper notice was given of the same and the hearings com-

menced on Monday, the 12th day of September, 1977 at the Commission's Hearing Room.

SCOPE OF THE HEARING

2. At the outset of these Proceedings on Rehearing, the Commission noted that it had already taken considerable evidence in the contemporaneously pending MOUNTAIN FUEL General Rate Case, P.S.C. Case No. 77-057-03 (II) with respect to a number of specific questions surrounding the MOUNTAIN FUEL-WEXPRO relationship, namely, the non-utility oil properties transferred by MOUNTAIN FUEL to WEXPRO under Purchase and Sale Agreement dated December 21, 1976, the past exploration and development activity of MOUNTAIN FUEL through its corporate utility and non-utility divisions, the Joint Exploration Agreement entered into between MOUNTAIN FUEL and WEXPRO on December 21, 1976, and the effect of said Agreement, the prior classification of development properties as utility or non-utility, MOUNTAIN FUEL's historic definition of gas and oil employed for classification purposes, the expenses incident to the exploration and development program and allocation thereof between the utility and non-utility accounts of the Company, the capital costs of exploration and development assumed by the owners of MOUNTAIN FUEL, the tax benefits to the utility accounts of the Company associated with exploration and development, the treatment of wildcat exploration and associated expenses, the relative success of the exploration and development program of MOUNTAIN FUEL, the Company's natural gas reserves, the average cost of MOUNTAIN FUEL's own production, the nature of the natural gas industry in the Rocky Mountain Area, the national significance of present and future natural gas supplies, and the future of exploration and development of MOUNTAIN FUEL.

3. Because of the days of testimony spent in the months of July and August in Case No. 77-057-03 (II) involved with MOUNTAIN FUEL-WEXPRO related questions and the pronouncement of the Commission that it did not intend to hear the same evidence and testimony a second time in the WEXPRO case, it was the intent of the Commission at the outset of the September 12, 1977, hearing that the testimony be directed and limited to three primary areas:

> (1) the presentation of certain particular amendments to the MOUNTAIN FUEL-WEXPRO Purchase and Sale Agreement and Joint Exploration Agreement which would govern prospectively the future relationship between the two companies, as the same had been previously discussed between counsel for all parties to the Case and generally outlined in oral fashion to the Commission at the August 23, 1977 Hearing;
>
> (2) the presentation and analysis of the comparative relationship between such proposed amendments to the Purchase and Sale Agreement and Joint Exploration Agreement and the December 21, 1976, Purchase and Sale Agreement and Joint Exploration Agreement which was then and is now in force between MOUNTAIN FUEL and WEXPRO;
>
> (3) the receipt of evidence incident to an acceptable and workable definition of natural gas and oil.

4. As the hearings went forward, it became manifestly apparent that all of the issues surrounding WEXPRO, the transfer of the non-utility oil properties by MOUNTAIN FUEL to WEXPRO, the previous exploration and development activities of the Company in its utility and non-utility divisions and other facets of the exploration and

development business had such relationship to the August 23, 1977 alternate amendments to the existent MOUNTAIN FUEL-WEXPRO Purchase and Sale and Joint Exploration Agreements that it was impractical for the Commission to confine the proceedings to the precise issues which it had initially intended in Paragraphs C and D of its August 29, 1977 Order. Consequently, the Commission permitted wide latitude in the receipt of testimony and evidence regarding exploration and development of MOUNTAIN FUEL, conditions in the industry, the existent Purchase and Sale Agreement, the properties transferred, the classification of the transferred assets as non-utility, and the Joint Exploration Agreement as well as the alternate amendments discussed between counsel for the parties on August 23, 1977.

5. In addition, all parties were afforded the opportunity to present any additional testimony on any aspects of the present exploration and development program of MOUNTAIN FUEL and WEXPRO, the historic exploration and development program of MOUNTAIN FUEL, and any additional suggestions or proposals of any party to amend the Purchase and Sale Agreement and Joint Exploration Agreement between the two companies. Thus, the Commission allowed evidence and extended argument by counsel during the course of the proceedings on all facets relating to the MOUNTAIN FUEL-WEXPRO transfer, including the classification or alleged misclassification of the transferred properties as non-utility assets, the nature and character of the exploration program of MOUNTAIN FUEL in its utility and non-utility divisions prior to the creation of WEXPRO, the contribution of expense funds to the exploration program of MOUNTAIN FUEL and the allocation of said costs between the

utility and non-utility accounts of the Company, the contribution of capital funds to the acquisition of leases and development of properties and payment of said costs by the owners of the Company, the history of exploration and development of MOUNTAIN FUEL, the success of MOUNTAIN FUEL's gas and oil discoveries, the cost of natural gas to MOUNTAIN FUEL from its own production in comparison with costs of alternative sources of supply without Company production, and the benefits and detriments to the utility customers, the shareholders, and the Company as a result of exploration and development.

6. Testimony and exhibits were further adduced as to the existent Purchase and Sale Agreement (MFS Exs. 1, 1A) and Joint Exploration Agreement (MFS Exs. 2, 2A), the alternate settlement amendments to said Agreements (MFS Exs. 4 and 5) as outlined on August 23, 1977, other proposals for amendments to or suspension of the existent Purchase and Sale Agreement and Joint Exploration Agreement between the companies, the financial impact of the various proposed amendments to the Agreements upon the capability of MOUNTAIN FUEL and WEXPRO to conduct capital financing, the economic capability of MOUNTAIN FUEL to continue a sound and progressive exploration and development program under the various proposed amendments to the Agreements, and the potentiality of a conflict of interest between the two companies in joint and individual exploration for natural gas and liquid hydrocarbons.

7. Testimony was further offered in connection with the future prospects of exploration and development in the Rocky Mountain Area, including the depths of future drilling, the probabilities of product discoveries, the com-

petitive nature of gas and oil exploration in the Rocky Mountain Area, the recent penetration by mid-west, southwest, and California based gas distribution utilities seeking gas finds in the historic exploration and development areas of MOUNTAIN FUEL in Wyoming, Colorado, and Utah, and the economic and practical viability of farm-out agreements between MOUNTAIN FUEL and third-party operators. Evidence was received on analyses of individual wells, formations and fields on the properties transferred by MOUNTAIN FUEL to WEXPRO as well as those still owned by MOUNTAIN FUEL, the economic feasibility of utilizing gas liquids and air injection methods for MOUNTAIN FUEL's utility gas distribution system, the fairness and equity of the exploration and development program of MOUNTAIN FUEL under the Joint Exploration Agreement with WEXPRO and a number of related and corollary matters.

8. A total of 12 witnesses were called, nine by MOUNTAIN FUEL and three by the Division of Public Utilities. The full hearings surrounding the MOUNTAIN FUEL-WEXPRO issues span approximately 4000 pages of transcript. Throughout the four weeks of Rehearing, it was the intent of the Commission that all issues surrounding the WEXPRO transfer and agreements could be aired by all parties to the proceeding and thereafter resolved with finality by this Commission. It is in the interest of MOUNTAIN FUEL, its customers, and the stockholders that such be done.

EXPLORATION AND DEVELOPMENT PROGRAM OF MOUNTAIN FUEL

9. From the corporate beginnings of MOUNTAIN FUEL in mid-1930's, the Company has been consistently

engaged in varying degrees of exploration and development for natural gas and oil in the Rocky Mountain Area. Its exploration activities have been centered principally in the States of Wyoming, Colorado, and to a lesser extent, Utah. Within its area of operations, MOUNTAIN FUEL has been one of the principal operators engaged in exploration and development of oil and gas hydrocarbons and is recognized in the industry as having a successful, aggressive and strong exploration and development program.

10. MOUNTAIN FUEL has undertaken and constructed over the years an elaborate network of gathering lines, compressor stations, sweetening, treatment and purification plants and related facilities in the field to bring its own natural gas production from the wellhead to major collection points. The Company, in turn, has also constructed two major transmission systems, one interstate through Wyoming and the other intrastate in Utah, which deliver field produced gas into MOUNTAIN FUEL's distribution system for ultimate sale and delivery to its natural gas customers in Utah and southwestern Wyoming. The gathering, compressor, treatment, and transmission facilities constructed by MOUNTAIN FUEL in the field have enabled it to take advantage of working interests with other field producers and to purchase natural gas from numerous sources to whom the Company would not otherwise have had access.

Separation of Gas and Oil Accounts.

11. In connection with its exploration and development activities, MOUNTAIN FUEL has maintained throughout the years separate accounts, as a part of its larger system of accounts, for its utility gas operations and

its non-utility oil operations. The utility gas capital accounts are Account 105 involving unexplored or wildcat acreage held for future use, and Account 101, the utility account in which development properties are held. Account 121 is the non-utility capital account which includes both acreage and physical plant for oil operations. Accounts 795, 796, 797 and 798 are utility expense accounts in connection with delay rentals, nonproductive well drilling, abandoned leases, and other exploration expenses. The Commission has required MOUNTAIN FUEL to keep separate its gas and oil accounts because of the regulatory jurisdiction over the sale of natural gas and revenues and because of the lack of jurisdiction over oil properties as well as the sale of oil products and the revenues derived therefrom. In a long line of decisions, this Commission has determined that the oil operations of MOUNTAIN FUEL were non-utility in character and were not a part of utility plant or rate base, that MOUNTAIN FUEL was not entitled to earn a fixed rate of return on its non-utility oil investment and properties, and that the Commission was without jurisdiction to regulate said assets or the associated revenues and expenses. *P.S.C. Case No. 3275,* pp. 7-8 (June 1948); *P.S.C. Case No. 3511,* p. 9 (April 1951); *P.S.C. Case No. 3972,* pp. 10-11 (November 1953); *P.S.C. Case No. 4392,* pp. 19-20 (February 1957); *P.S.C. Case No. 4797,* pp. 51-52 (February 1968); *P.S.C. Case No. 6369,* pp. 15, 17 (February 1972).

12. Without interruption, MOUNTAIN FUEL has continued over the years and through December 31, 1976, to segregate its oil properties and assets into the non-utility 121 Account separate and apart from its utility gas properties in Accounts 105 and 101. Such separation has permitted the utility to make an accounting in the rate mak-

ing process before this Commission which isolates non-utility properties and avoids their inclusion in the utility rate base or expenses for rate making purposes.

Purpose of Exploration and Development Expense.

13. This Commission, for over 25 years, has expressly recognized the public benefits from a strong natural gas exploration and development program by MOUNTAIN FUEL. *P.S.C. Case No. 3650,* p. 3 (June 1951); *P.S.C. Case No. 4392,* p. 17-19 (February 1957). The test of the successfulness and the public interest characteristics of the exploration and development activites of MOUNTAIN FUEL over the years is not gauged by quantifying the exploration expense of the program to the utility, but rather is measured by the ability of the Company to secure proven natural gas reserves for the present and future use and benefit of the Utah utility customers at a reasonably low cost below the market price. See specific language in *P.S.C. Case No. 4797,* p. 13 (February 1960) and *P.S.C. Case No. 5907,* p. 8 (July 1968). To encourage exploration and development for natural gas, this Commission, as early as 1947, in establishing fair and reasonable natural gas rates in Utah, authorized MOUNTAIN FUEL to include in the Company expenses a designated sum for all or a portion of its annual exploration expense. *P.S.C. Case No. 2906,* pp. 22-25 (November 1947). Thereafter, the Commission in periodic review of MOUNTAIN FUEL's rates and charges, continued to find that exploration was a just and reasonable expense of MOUNTAIN FUEL, along with other expenses, as part of the utility functions of the Company. *P.S.C. Case No. 3650,* p. 3 (June 1951); *P.S.C. Case No. 4392,* p. 19 (February 1957); *P.S.C. Case No. 4797,* p. 12, 17 (February 1960); *P.S.C. Case No. 5907,* pp. 8, 11 (July 1968); *P.S.C. Case No. 6369,* pp. 13-15

(February 1972); *P.S.C. Case No. 6668*, pp. 7-9 (July 1974); *P.S.C. Case No. 7113(II)*, pp. 13-14 (December 1975).

14. In our review of the testimony herein and past Orders of the Commission, it is apparent that exploration expense has always been found to be just and reasonable in some amount and the Commission has never determined that exploration for natural gas was unreasonable and inappropriate for the utility operations of MOUNTAIN FUEL. The allowance of the exploratory expense in the rates was specific and well understood. Such expense was and would only be used to cover direct exploration expense and not for the capital expenditures or costs incident to development. Lease maintenance, dry hole exploration, abandoned leases, and other associated direct expenses were chargeable to the authorized exploration expense. If exploration resulted in a commercial gas discovery and consequent production, the full expenses incident to the drilling of said exploratory well were capitalized, with such cost being borne by the owners of the Company and the asset reflected in the capital Account 101 of MOUNTAIN FUEL. The costs of a successful gas exploration well or a gas development well have never been and are not paid from the annual exploration expense authorized in the rates of the Company, but rather such costs are capitalized and financed by the Company owners. See, *P.S.C. Case No. 4392*, p. 18 (February 1957).

15. In authorizing MOUNTAIN FUEL an annual exploration expense to be reflected in its rates and charges for the sale of natural gas in Utah, this Commission has consistently expected on the part of MOUNTAIN FUEL two factors:

(i) a diligent exploration and development program in securing natural gas reserves for present and future use of utility customers; and

(ii) that such gas, when placed in production, be brought into MOUNTAIN FUEL's system at cost of service. *P.S.C. Case No. 4797*, p. 13 (February 1960).

Exploration Expense in the Rates in Return for Cost of Service Gas.

16. There has been a rule well understood and followed by the Commission in previous Orders, by MOUNTAIN FUEL, and by parties who have traditionally participated in MOUNTAIN FUEL rate cases, with respect to the exploration expense reflected in the rates and charges for the sale of natural gas from MOUNTAIN FUEL production. Simply put, the rule was that in consideration for the recognition of an exploration expense in the rates and charges of MOUNTAIN FUEL, gas discoveries found and production therefrom would come to MOUNTAIN FUEL at the cost or service price rather than the market price of production. The shareholders of MOUNTAIN FUEL were thus given notice early-on and thereafter throughout the exploration and development history of MOUNTAIN FUEL that the arrangement would be a "this for that" proposition, i.e., an exploration expense in that rates in return for low priced cost of service gas. As to said product, the shareholders would not expect to receive the market price obtained by their competitors in the field as to those gas properties classified and dedicated to MOUNTAIN FUEL's distribution system in the State of Utah.

17. Prior Commission Orders clearly demonstrate that the Commission anticipated, as a result of the trade-off of the exploration expense in the rates in return for cost of

service gas, MOUNTAIN FUEL's own production would be brought in at a price lower than the market which other field producers or pipline suppliers obtained. *P.S.C. Case No. 4392,* p. 19 (February 1957); *P.S.C. Case No. 5907,* pp. 7-8 (July 1968); *P.S.C. Case No. 7113,* p. 9 (December 1975). Those competitors of MOUNTAIN FUEL who receive the full market price for pipeline quality natural gas are found in both intrastate commerce, their sales being subject to the regulation of this Commission, and interstate commerce, where the sales are subject to regulation of the Federal Power Commission. The anticipation of previous Commissions as to the price of MOUNTAIN FUEL's own production measured as against that received by the Company's competition in the market has proven itself correct in today's intense and competitive natural gas market. The evidence in this case plainly reflects that the historical rolled-in price of MOUNTAIN FUEL's own production comes to its distribution system at approximately $.40 per Mcf whereas the average field price which MOUNTAIN FUEL's competitors receive from the sale of natural gas to MOUNTAIN FUEL is $1.16 per Mcf and the average price received by pipeline companies, also in competition with MOUNTAIN FUEL for gas discoveries, is $1.46 per Mcf. The evidence further demonstrates that the price of field and pipeline natural gas in interstate and intrastate commerce is likely to continue to rapidly accelerate in the days ahead with new field produced gas reaching a price of $1.75 per Mcf plus taxes and gathering allowances and most pipeline gas reaching a price of $2.25 per Mcf by 1978. Dr. Bass, a witness for the Division, estimated that by 1990, the cost of field produced gas would be $4.80 per Mcf. We have during the last several years entered a new era of national significance in the natural gas industry occasioned by high demand and short

supply of natural gas. This is a condition that was quite unknown prior to 1973 to the nation or to the Rocky Mountain Area. Such advent has confirmed the foresight of previous Utah Commissions and of MOUNTAIN FUEL in developing Company-owned gas reserves through a continued exploration and development program over the years.

Historic Treatment by the Commission of Oil Discoveries.

18. The Commission has further recognized in its Orders that exploration for natural gas reserves would inevitably lead to discovery of oil and heavier forms of hydrocarbons than standard, pipeline quality gas. E.g., *P.S.C. Case No. 3275,* pp. 7-8 (June 1948). The concept has long been accepted that as a corollary to the understanding that gas reserves would be developed by the Company and sold in its system at the lower cost of service, if exploration and development resulted in oil hydrocarbons and associated liquids said discoveries would be unregulated and the owners of the Company would be entitled to sell such product, and maintain the revenues therefrom, at a competitive market price in the field. The Commission has consistently found that it does not have jurisdiction to regulate production and sale of oil and heavier liquid hydrocarbons than marketable natural gas. E.g. *P.S.C. Case No. 4392,* pp. 19-20 (February 1957). With respect to oil finds and associated liquids, said properties have not been determined to be used and useful in the utility functions of the Company, said properties have not been included in the rate based or plant of the Company for rate of return or rate making purposes, e.g. *P.S.C. Case No. 3972,* pp. 10-11 (November 1953), and the Company has sold such products at the full market price in competition with its competitors in the field. Since

said oil and associated properties are not used and useful in the utility functions of the Company as defined by law and are not subject to regulation by this Commission, the Commission has required and authorized MOUNTAIN FUEL over the life of the Company's exploration and development program to maintain its oil discoveries and associated liquids in a separate non-utility oil Account 121 as defined by the Uniform System of Accounts.

Historic Classification of Oil and Gas Wells

19. The maintenance of the gas utility accounts separate from the non-utility oil account necessarily required that a definition be established to determine whether a producing well should be characterized as gas or oil. The testimony is uncontested in this case that as far back as any witness could recall and into the mid-1940's, there was in custom and usage by MOUNTAIN FUEL a procedure to determine whether a discovery was a gas well or an oil well. The well classification was dependent upon the value of the product as it was drawn from the ground and measured at the wellhead or the field separator facility. If the gas production in a discovery well, measured by the price in the field at that time, exceeded the field value of oil produced at the same time, the well was classified by MOUNTAIN FUEL as a utility gas well and the cost of such well, including development, was thereafter capitalized in the utility accounts of the Company. On the other hand, if a discovery well were greater in its value of oil than it was of gas under the same field test and measurement, the well was classified as a non-utility oil well and the costs thereof capitalized in Account 121, the non-utility oil account.

20. If a productive well were defined as a gas well, all heavier hydrocarbon products associated with such productive well went with the predominant product, in this case gas, and the sale of such products was reflected in Account 492, incidental gasoline and oil sales. If the well were defined as an oil producer, however, all natural gas associated therewith went to the non-utility account of the Company and if that gas were thereafter brought into MOUNTAIN FUEL's distribution system, the non-utility account was credited with the field price for said gas. An example of a gas field of MOUNTAIN FUEL with associated heavier hydrocarbons credited to the utility, is Church Buttes-Dakota in the State of Wyoming. An example of an oil field having associated natural gas is the Birch Creek-Almy Field in southwestern Wyoming. Ex. RMK-1.

21. Initially acquired acreage in the exploration and development program of MOUNTAIN FUEL has always been handled as a capital cost and the annual exploration expense of the Company has not been used to pay such expenditures. Any annual delay rental on wildcat acreage, prior to discovery and production, has always been an expense item. When a discovery was made in a particular field, that acreage which was logically related to the major formation in the field has been transferred and capitalized in either the utility gas account or the non-utility oil account dependent upon the classification of the well or wells. If more than one well were located in a participating area established by the United States Geologic Survey, all such wells were classified on the basis of their total production as if they were a singular well and all acreage in said participating area was classified utility or non-utility on the basis of the total well production of gas and oil in the area consistent with industry practice.

22. The historic usage of gas and oil well classification

as set forth above has never been reduced to a specific writing by the Commission or the Company. The Commission has referred generally to the classification method and in various instances to a particular field in which it was utilized. For example, in the 1948 Order *P.S.C. Case No. 3275,* pp. 7-8 (June 1948), the Commission stated that the recently discovered Church Buttes Field was in the first stages of production and while it was known that the formation conained gas, condensates, liquids and crude oil, the Commission stated that classification would have to abide further production. It turned out that Church Buttes was classified as a gas field and has been and still is one of major discoveries in MOUNTAIN FUEL's system. The Commission has subsequently expressed further understanding of the gas and oil well classification used by the Company. See, *P.S.C. Case No. 4797,* pp. 9-10 (February 1960); *P.S.C. Case No. 6369,* p. 15 (February 1972); *P.S.C. Case No. 6668,* pp. 7-8 (January 1974). MOUNTAIN FUEL, itself, has never formulated a codified statement of the classification system. Its explanation for such is that the classification system was understood and used by MOUNTAIN FUEL and the Commission over the years and that prior to 1972, and the subsequent energy shortage which has confronted this country, the oil operations of MOUNTAIN FUEL were a relatively minor aspect of MOUNTAIN FUEL's exploration and production operations. Nonetheless, the claim has been made by several protestants that the past classification system of MOUNTAIN FUEL was undefined and has not been applied with an evenhand. The great and preponderating testimony is that the classification system was extant, known generally, reviewed from time to time by the Commission as to particular fields or wells, and that on balance it was applied with reasonable consistency. As a practical

matter, the testimony is uncontested that only a relatively small proportion of productive wells contained commercial amounts of both gas and oil. Out of 163 wells brought into production by MOUNTAIN FUEL since 1967, only 22 contained both quantities of gas and oil, and of those, only one was within the range of 30%-70% oil to gas or gas to oil. Thus, during the last ten years, less than 14% of the productive wells brought in by MOUNTAIN FUEL presented an issue as to the application of the Company's gas and oil classification system.

Recent Gas and Oil Finds.

23. A large portion of MOUNTAIN FUEL's exploration and development in more recent years has been carried on with other oil and gas exploration companies in the field. The high cost of exploration and development and competition for and diversity of land leaseholds has required that MOUNTAIN FUEL explore with other partners in the field. As a result, the policy with respect to what acreage is drilled and how it is produced rests not only with MOUNTAIN FUEL, but with its ownership partners and is further dictated by regulations of the United States Geologic Survey. The magnitude of the expense and risk attendant drilling to deeper formations in an inflationary economy as well has required that MOUNTAIN FUEL join in joint venture or partnership agreements with field producers.

24. MOUNTAIN FUEL has most recently been involved in continued development of deep drilling at its Church Buttes property, Kinney, and Butcherknife, all gas fields. Such fields have not only been major gas discoveries for MOUNTAIN FUEL in recent years, but associated and incidental gas liquids have been or will be produced at

Church Buttes and Butcherknife which have benefited and will inure to the utility. In 1976, the associated utility oil and gas liquid sales were $1,546,879 with previous years being even higher.

25. During 1976 and the current year, 1977, substantially all of MOUNTAIN FUEL's present drilling has been and is directed to development of acreage having already indicated gas finds, as gas has been historically defined by the Company.

26. Oil discovery by MOUNTAIN FUEL, on its own, or in conjunction with partners in the field, played a relatively minor part of the Company's exploration and development program prior to 1972. Through that point, there had been no major oil field developed. The owners of the Company were following the understanding that they would be allowed a price for natural gas discoveries at cost of service rather than the market price in return for the annual exploration expense in the rates and the owners were entitled to sell the nonregulated non-utility oil production at market with the revenues therefrom going to the general funds of the Company.

27. In 1972, Champlin Oil Company (a wholly owned subsidiary of Union Pacific), as the operator and MOUNTAIN FUEL and Amoco Production Company as partners, drilled to the Weber Formation at the Brady Unit in Sweetwater County, Wyoming, and discovered a significant retrograde reservoir, which was rich in oil. The Weber also produced a gas stream which, after separation of the oil, contained some gas liquids and high concentration of hydrogen sulfide, H_2S, and carbon dioxide, CO_2. The development of the formation was designed so that the gas stream, after the gas liquids were extracted, was compressed and reinjected into the Weber formation to main-

tain pressure in the reservoir. The testimony is uncontested that the Brady Field, particularly the Weber Formation, is a prudently operated and well managed property. The Weber No. 1 well at Brady was classified as a non-utility oil producer. Other development wells have been drilled in the Weber, Nugget and Dakota formation, the latter two of which produce crude oil and natural gas respectively. The discovery of oil at Brady has sparked significant controversy and debate before this Commission in recent years in matters involving MOUNTAIN FUEL, with requests made by protestants and intervenors that the revenues from the oil formations be utilized in one form or another, for the purpose of lowering utility gas rates for the sale of the Company's own natural gas production.

28. In 1973, MOUNTAIN FUEL made an oil discovery in the Frontier formation of the Spearhead Ranch area in northeastern Wyoming in partnership with Anadarko, Champlin, Southland Royalty and certain individuals. On the basis of this discovery and a previous adjacent completion which was also oil, all MOUNTAIN FUEL leases in the area were transferred to the non-utility accounts. The Spearhead Ranch area was unitized with the Frontier formation within the unit boundary declared a participating area by the U. S. Geologic Survey. All production from wells within the participation area is treated as if it were the production of one well.

29. The only other significant oil producing formation in the MOUNTAIN FUEL system in recent years is the Dry Piney Nugget formation. This formation was first discovered in 1969 by MOUNTAIN FUEL with Belco and Exxon as partners. The Frontier Formation had been previously developed as a gas field but by 1972 the value of oil production from the Nugget formation was far in excess

of gas production in the Field and the leasehold interests were transferred to the non-utility accounts. However, the gas wells and formation were reserved to the utility.

RESULTS OF MOUNTAIN FUEL'S EXPLORATION AND DEVELOPMENT PROGRAM

30. The resultant aspects of MOUNTAIN FUEL's exploration and development activities are of note. The record in this case reflects that since 1960 there has been expended a utility exploration expense of $56,795,000, $44,981,000 of which has been authorized by the Commission to be reflected in the rates and charges of MOUNTAIN FUEL for the sale of natural gas. During the same period, the shareholders of the Company have advanced or underwritten utility production and gathering facilities in connection with exploration and development of $87,721,456, no part of which has been recognized in the dry hole exploration expense. During said time frame, MOUNTAIN FUEL received $93,846,000 in tax deductions that had direct relationship to the exploration and development program and which were passed on to utility customers in the form of lower rates. During said 17 year period, MOUNTAIN FUEL failed to achieve its authorized rate of return on utility plant by some $37,665,000. The Company claimed in its evidence that by reason of such deficiency, it had only recovered in the rates and charges for 17 years of exploration expense the difference between the deficiency ($37,665,000) and the exploration expense authorized by the Commission ($44,981,000) or $7,316,000. That argument is only completely sound if the Commission were to follow the concept of fund tracing which it is not inclined to do. However, since the position of the Division and other protestants (that "ratepayer

funds" have directly paid for the exploration and development program of MOUNTAIN FUEL over the years) is also a fund tracing theory, the position of MOUNTAIN FUEL is entitled to some weight as a counter balance.

31. The Commission finds, however, that the proper measure of success of the exploration and development program of MOUNTAIN FUEL is the criteria which it has historically used, i.e., that dedicated or proven gas reserves to MOUNTAIN FUEL's system at a cost of service that is at the lowest reasonable price. In that connection, the evidence is undisputed that:

> (i) MOUNTAIN FUEL has added to its total system reserves between 1960 and 1976 an additional 1.6 trillion cubic feet of natural gas from field sources, of which 615.9 billion cubic feet is directly attributable to its own production. The balance of 984.1 billion cubic feet of dedicated reserves stems from the call MOUNTAIN FUEL has on the gas of its partners in the field and other independent field producers who have production that are adjacent to MOUNTAIN FUEL's gathering and transmission lines and facilities.
>
> (ii) The average cost of service gas brought into MOUNTAIN FUEL's system from its own production is $.40 per Mcf. Such is compared to the average 1977 field price of $1.16 per Mcf for independent producers and a 1977 average pipeline price of $1.46 per Mcf.
>
> (iii) MOUNTAIN FUEL's own production at a rolled-in price of $.40 per Mcf consitutes better than 30% of its entire system requirements for 1977. No witness was able to cite to the Commission any other gas distribution utility in the United States which has a larger percentage of its system needs found in its own production.
>
> (iv) The ratio of MOUNTAIN FUEL's reserves backing its own production to its entire system

reserves has increased from 33% in 1969 to 40% in 1976, during a time that has found the Country facing a natural gas shortage.

(v) Between the years 1960 and 1976, if MOUNTAIN FUEL had not had its own exploration and production program and had been required to purchase its entire system needs from independent field and pipeline sources, the increased purchased gas costs to MOUNTAIN FUEL as a result thereof would have been $74,307,000. If MOUNTAIN FUEL had not had its own exploration and production program for said period and had been able to buy only from pipeline sources, the additional purchased gas costs of MOUNTAIN FUEL for the 17 year time frame would have been $123,295,000.

(vi) MOUNTAN FUEL has a present reserve life index of natural gas supplied of between 14 and 15 years, a substantial portion of which is as a result of its own exploration and production program. The national average reserve life index for gas distribution utilities is 10-11 years.

CLAIMS OF PROTESTANTS ON EXPLORATION AND DEVELOPMENT PROGRAM

32. All of the Protestants in the Case argued that the exploration and development program of MOUNTAIN FUEL has been unfair and inequitable because of a bias in favor of the shareholder and against the utility customer of the Company. The basis of the claim as stated by Division witness Norman is that because of the annual exploration expense authorized by the Commission in the rates of MOUNTAIN FUEL, and because of the inclusion of leaseholds held for future use, Account 105, in rate base, the utility customers have directly paid for the exploration and development program of the Company. Thus, it is claimed that the customer has borne the risks of the entire exploration and development program of MOUNTAIN FUEL over the years, whereas the shareholder has taken the benefits of the program. The testimony of the Division indicated that between 1966 and 1976, the utility account of MOUNTAIN FUEL paid for 73.3% of the dry-hole exploration expense with the non-utility oil accounts paying for 26.7% of said expense, that cancelled and delayed rental on leases was borne approximately 95% utility to 5% non-utility and of the total exploration expenses for the ten-year period, some $37,250,000 was paid by the utility accounts with $8,222,000 paid by the non-utility accounts of the Company.

33. Mr. Norman did not contest the Company's evidence that over 95% of leaseholds currently in the utility Account 105 had been acquired since 1972. Since 1972, because of the relationship of the non-utility oil activity to the exploration and development program of MOUNTAIN FUEL, this Commission has determined that it was fair, reasonable and in the public interest that the non-utility oil accounts begin to bear a larger proportion of the annual exploration expense than had previously been the case when the non-utility oil operations were a relatively insignificant portion of the Company's total operation. In 1972, the Commission established a requirement that the non-utility accounts bear an absolute dollar amount of $300,000 of the total exploration and development expense. *P.S.C. Case No. 6369,* p. 20 (February 1972). In 1974, the absolute dollar amount was revised to an allocation to the non-utility of 32.88% of the total annual exploration expense. *P.S.C. Case No. 6668,* p. 7 (July 1974. Finally, in 1975, after an exhaustive study was presented by Martin Toscan Bennett, the Commission ordered the non-utility oil account of MOUNTAIN FUEL

to share equally with the utility gas account in the annual exploration expense. *P.S.C. Case No. 7113 (II)*, pp. 13-14 (December 1975). Division Exhibit No. 1 demonstrates that since 1974, the non-utility oil account of MOUNTAIN FUEL has contributed $6,600,000 to the annual dry-hole expense with the utility gas accounts contributing $4,245,000 for such purpose. All of said expense information as set out in Division Exhibit 1 was calculated through the end of December, 1976, and prior to the transfer of the non-utility oil properties to WEXPRO effective January 1, 1977. Since January 1 of this year and to the present, WEXPRO is paying 50% of all the exploration expense on joint exploration acreage currently being drilled by MOUNTAIN FUEL and WEXPRO.

34. While the policy witness for and Director of the Division, Mr. Lambert, did acknowledge that the exploration and development program of MOUNTAIN FUEL had been successful and was important, accountant Norman made no reference to any benefit to the utility customer. Mr. Norman further stated that the discovery success of the Company's gas exploration and development program over the years was irrelevant to the question of fairness and equity of the program and expressly disagreed with an earlier holding of this Commission that:

> "The validity or success of an exploration and development program cannot and should not be measured in terms of number of dollars expended in drilling dry holes. The volume and cost per Mcf of new gas reserves found is the proper index of the success of such a venture." *P.S.C. Case No. 4797*, p. 13 (February 1960).

35. The argument of the Protestants boils down to the allegation that the ratepayers, through their monthly natural gas bills, have paid for the exploration and

development program of MOUNTAIN FUEL, a risky business, and as a result, they have a right to have the revenue resulting from such program applied to the reduction of their utility gas rates. Such position, while understandable in part, does not square with the facts and the law in these Proceedings. The utility customer of MOUNTAIN FUEL neither pays the cost of exploration and development nor bears the risk of the same. The utility customer pays for natural gas which he purchases and even though the natural gas rate reflects an expense for exploration, no part of the gas bill is earmarked for that purpose any more than for any other expense item of the Company. This Commission has previously stated the proposition in *P.S.C. Case No. 4392*, p. 18 (February, 1957):

> "It should be made clear, however, that in making allowance in rates for nonproductive well drilling the customer of applicant will not be required to provide capital for the drilling of productive wells on which the applicant will expect a return. The dry hole allowance is strictly an item of annual expense."

The risks of success of the exploration and devlopment program are burdens which, in the first and last analyses, we place on the Company and its shareholders. If the program is unsuccessful or unproductive and does not yield new low cost natural gas reserves, it is not the utility customers that must account for such, but rather it is the Company, its management and its owners who must shoulder responsibility before this Commission and in the capital markets. All exploration and development expenses of MOUNTAIN FUEL are paid from the general funds of the Company and not from specifically earmarked funds. When a discovery is made, all drilling and

associated expenditures connected therewith are capitalized in the capital utility or capital non-utility accounts of the Company and no part of such expenditures are paid from the annual exploration expenses which this Commission has authorized in the rates. The costs of all successful development wells and associated expenditures and capital costs are not in any part satisfied by the annual exploration expenses. Capital expenditures have been and are paid from the Company's general funds, which includes monies raised through the sale of debt or equity securities for which the owners of the Company are responsible. Without the investment of capital funds to satisfy the costs of all successful discoveries, there would be no MOUNTAIN FUEL exploration and development program.

36. Even given the position of the Protestants, that position is predicated upon the assumption that MOUNTAIN FUEL, for each of the years in which the exploration expense was authorized by this Commission, has earned the full rate of return also authorized by the Commission. So far as rate-making policy and theory is concerned, it is only when the Company has earned its full rate of return that the expenses of the Company are fully covered by and recognized in the rates and charges from the sale of natural gas for that period. The evidence of this case is that between 1960 and 1976, MOUNTAIN FUEL was $37.6 Million deficient in its rates whereas the exploration expense authorized for the same period was $44.9 Million. If the Protestants were entitled to engage in fund-tracing of the annual exploration expense, that expense would have to be significantly reduced by the deficiency in the rate of return experienced by MOUNTAIN FUEL for the same time frame, because the stockholders of the Company were required to pay the expenses of exploration to the extent

that they did not receive what was authorized by this Commission as a fair rate of return on their capital. The answer to both the Protestants and MOUNTAIN FUEL on the issue, however, is that the Commission declines, as it has in the past, to engage in a fund tracing exercise in the Case. *P.S.C. Case No. 7113 (II)* (December 1975).

37. We believe that the rationale expressed by the United States Supreme Court in *Board of Public Utility Commissioners v. New York Telephone Company,* 271 U.S. 23 (1925), is applicable to this Case:

> "The Customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary. The revenue paid by the customers for service belongs to the company. The amount, if any, remaining after paying taxes and operating expenses including the expense of depreciation is the company's compensation for the use of its property. * * *
>
> "Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock." (271 U.S. At 31-32)

38. It is unquestioned that the ratepayers of MOUNTAIN FUEL are entitled to a determination by this Commission that the exploration expense is just and reasonable, that its gas service is efficient and reliable, and

that the service be at the lowest reasonable cost. But beyond that, the Protestants are not entitled to fund-trace assets. This Commission has, in every MOUNTAIN FUEL case in which exploration and development has been an issue, made a finding that the exploration expense, at that time and under the then existing circumstances, was just and reasonable. Such finding was made as to all other expenses of the Company whether they be employee salaries, paper purchases, or maintenance costs. In the entire history of regulation before this Commission, we do not know of any order issued by the Commission and we have been referred to none in which there has been a finding that the exploration expense reflected in the rates of MOUNTAIN FUEL was unjust and unreasonable. Once the Commission has determined an expense to be just and reasonable and there is no appeal and the case is thereupon closed and not thereafter reopened, that finding is determinative on the issue of the reasonableness of the expense for the particular time under said Order. We do not think it is wise public policy to attempt a hindsight examination or to attempt to second-guess the decisions made by earlier Commissions in prior orders under a factual record then existent.

39. This Commission has always retained the option of refusing to allow any prospective exploration and development expense in establishing reasonable rates for natural gas service if the exploration program does not provide sufficient benefits to the utility customers of MOUNTAIN FUEL to justify the continued expense. However, the results of the program as set out above have given the Commission no reason to depart from past practice at the present time.

The Commission Decision in Case 6668.

40. Throughout the course of these Proceedings, the Commission has heard argument and testimony regarding the Findings of Fact and Conclusions of Law of the Commission in *P.S.C. Case No. 6668.* The Protestants have taken the position that the Findings of Fact set forth in the January 14, 1974, Report and Order of the Commission in that case are controlling on many of the issues presented in this Case. The Company on the other hand has taken the position that the Findings of Fact which formed the basis for the Commission's conclusion that the non-utility oil operations should be merged with the utility gas operations for rate making purposes were reversed by the subsequent rulings of the Commission in that Case on January 21, 1974, February 26, 1974 and July 18, 1974. The Commission has had occasion to review the Order and Proceedings in Case No. 6668 in connection with such argument and evidence in this matter.

41. The January 14, 1974 Order of the Commission states at page 11:

> "We conclude that the only practical and equitable way to account for applicant's investment, revenues, and expenses associated with its oil and other liquid hydrocarbons production and sale is to include such investment, revenues, and expenses in Applicant's appropriate utility accounts for rate making purposes. This treatment does not in our opinion result in the inclusion of nonutility items in setting rates. Nor do we consider we are in any way transferring the Applicant's assets to its ratepayers. Clearly, the ratepayers have no specific interest as such in any of the Applicant's assets. We are of the opinion that the oil operations are so incidental to and inseparable from the production and sale of natural

gas as to be part of Mountain Fuel's utility operations and any other treatment would be purely arbitrary and based upon conjecture and speculation. We appreciate that this is contrary to the position of the Commission in the past but we believe our conclusions in this case constitute a better solution to this difficult problem."

The January 21 Supplemental Order holds that:

> "The Commission is fully cognizant of the extensive Findings and Conclusions set out in the Commission's Report and Order herein issued on January 14, 1974 (January 14th Report and Order herein) pertaining to the inclusion of the oil investment, revenues and expenses of Mountain Fuel Supply Company in reaching a determination of the request of Mountain Fuel Supply Company for a rate increase. The Commission entered those Findings and Conclusions only after thorough study, and it does not at this time, in this Order, recede therefrom. The Commission may, in some future case, determine to modify or recede from the said Findings and Conclusions, but does not hereby do so."

In its Final Order in the Case issued July 18, 1974, the Commission stated:

> "Although certain of the findings and conclusions in the January 21st Report and Order and this Report and Order are inconsistent with certain of the findings and conclusions of the January 14th Report and Order, sufficient reason has not been demonstrated in the hearings subsequent to the issuance of the January 14th Report and Order to warrant striking any of the findings and conclusions contained therein. Those findings and conclusions were based on the record as it then existed. Subsequently, facts and circumstances developed which required the issuance of the January 21st Supplemental Order and this Report and Order, and to the extent the findings, conclusions, and order herein and in the January 21st Supplemental Order are inconsistent with the January 14th Report and Order, this Report and Order necessarily takes precedence and is controlling."

In the January 14 Order, the Commission concluded that merger was "the only practical and equitable way" to handle the non-utility oil operations for rate making purposes and that "any other treatment would be purely arbitrary and based upon conjecture and speculation". Thereafter, as part of the July 18 Order, the Commission found against merger. Accordingly, we find that for the purposes of Case 6668, the rationale of the January 14 Order was impliedly if not expressly set aside and overturned. Any other finding would necessitate a finding that the July 18 Order was arbitrary and based upon conjecture and speculation.

42. After careful consideration of all of the evidence dealing with the exploration and development program of MOUNTAIN FUEL and in light of the foregoing Findings and Conclusion, the Commission concludes that the language of the January 14 Report and Order in Case No. 6668 with respect to the ratepayer risk, ratepayer rip-off and exploitation of MOUNTAIN FUEL customers is erroneous and should not stand as fact or law. All prior and subsequent Orders of the Commission reached an opposite conclusion based on a correct balancing of the interests of customers and shareholders of the company and this Commission herein affirms that long line of precedent.

Claims of Misclassification.

43. The Division primarily through witness Norman, claimed that the system of classification of wells as gas or oil by MOUNTAIN FUEL was unfair, undefined and the

subject of abuse. The basis for such contentions was the development and classification of the Spearhead Ranch-Fox properties in northeastern Wyoming and the Brady properties in southeastern Wyoming. Dr. Bass stated that certain questions were raised by the treatment of these properties but indicated that there may not have been any property misclassification. Mr. Norman testified that:

> (i) 29,000 acres at Spearhead and 4,000 at Brady, on which the utility had paid delay rentals for many years, were improperly transferred to the non-utility accounts of MOUNTAIN FUEL with the completion of only one well at each field.
>
> (ii) Spearhead Well Nos. 2 and 3 were intentionally completed in a noncommercial gas formation after coming up dry in the target oil formation to shift the heavy drilling expenses from a non-utility loss to a utility capital expenditure to be included in rate base.
>
> (iii) Spearhead Well Nos. 1A, 4 and 6 were not classified as individual wells to prevent them from being utility gas wells.
>
> (iv) Fox Well Nos. 1-5, 1-7 and 1-8 were reclassified as gas wells after January 1, 1977, so that such nonprouctive wells could be transferred to MOUNTAIN FUEL and put into rate base.
>
> (v) MOUNTAIN FUEL should have known from the outset that the Spearhead Ranch-Fox wells would all eventually turn to gas wells and should have classified them on the basis of future reserves rather than production.

Dr. Bass stated that as to the Weber Formation at Brady, the hydrocarbons are in a gaseous state in the reservoir. Furthermore, Well No. 13W would have been classified as a gas well if there were no Brady gas plant and Well No. 14D was improperly completed to shift expenses from the non-utility to the utility.

44. The cross examination of Division witnesses and the testimony on Rebuttal indicated that as to said properties:

> (i) The discovery wells in the Frontier formation at Spearhead and the Weber formation at Brady indicated major or very large productive oil fields. The Spearhead and Brady leases had been in Account 105 for only a few years with total delay rentals of $45,699 having been paid. Production from each of said fields to December 31, 1976, based upon the value of production at the well or field separator was substantially on the side of oil as contrasted to gas. The conclusion of Company personnel made at the time of the discoveries and initial production in each field, based on what was then known, was that all lease acreage transferred at both Spearhead Ranch-Fox and Brady was logically related to the oil finds made.
>
> (ii) Spearhead Well Nos. 2 and 3 were originally scheduled for completion in the deeper gas formation (Lakota) and the completion funds were almost fully expended prior to hitting the gas formation to prevent another blowout of the type that had earlier occurred in the shallower Frontier oil formation. Initial production from the wells was not only significant but apparently of a commercial character. After initial production and classification, the wells did decline in production as some wells unfortunately are inclined to do. But there is no testimony that the fall-off was foreseeable at the time of beginning production and classification. Under the Company's classification system the wells were clearly gas wells on December 31, 1976.

(iii) Spearhead Well Nos. 1A, 4 and 6 are all in the Spearhead Ranch Frontier participating area and are all classified together because they must be treated as one well. MOUNTAIN FUEL's classifi-

cation system provides that all wells in a participating area be considered as one well.

(iv) It was not determined that the Fox Federal wells had shifted in value of production, primarily as the result of a large F.P.C. gas price increase, to gas until the books were closed on the fourth quarter of 1976 which occurred in early 1977. Upon such determination that the wells had been gas wells under the Company's definition as of January 1, 1977, they were transferred from WEXPRO to MOUNTAIN FUEL.

(v) Although the wells in the Spearhead Ranch unit do appear to have a tendency to shift from oil to gas production over time, they had to be evaluated on production as of the date of the transfer in accordance with the Company's classification system. Even assuming that estimated reserves were the basis for classification, total estimated reserves for the Spearhead wells indicate that they are predominantly oil wells.

(vi) The Brady Weber well effluent is predominantly liquid at the surface and the effluent is sold by the barrel to refineries. Well No. 14W was erroneously labeled on a report as Well No. 14D. Well No. 14D never existed. Well No. 14W was always intended to be and was completed in the Weber oil formation at Brady. The Division used incorrect prices in valuing the production of Well No. 13W. Using the correct prices, it is an oil well even without considering the liquids extracted from the gas stream in the gas plant.

Conclusions on Classification.

45. Based on all of the evidence before us, the Commission finds that the properties and acreage at Spearhead Ranch-Fox and Brady were reasonably classified in a manner consistent with Company practice. The Division has raised questions regarding both Fields which needed to be asked and which required a response from

MOUNTAIN FUEL. With the response in, it is our determination that MOUNTAIN FUEL acted in good faith in concluding that based upon all of the information relative to the properties and acreage at the time that production was commenced, that properties at Spearhead and Brady should be categorized as oil. We believe it to be ill-advised to permit the classification system of MOUNTAIN FUEL to be judged upon hindsight and subsequent events or data which was not known and could not be reasonably foreseen at the time that the classification determination was made. After weighing all of the evidence, we find that MOUNTAIN FUEL acted in good faith in classifying the acreage at Spearhead-Fox and Brady and that said properties were properly in the non-utility accounts as of January 1, 1977.

CONCLUSION ON MOUNTAIN FUEL'S HISTORIC EXPLORATION PROGRAM

46. The touchstone of the exploration and development program of MOUNTAIN FUEL, as recognized by this Commission since at least 1947 through January 1, 1977, has been that the allowance of an exploration expense in rates in consideration for natural gas reserves at the utility's cost of service rather than market price, with the adjunct that any oil or associated liquid hydrocarbons discovered during the process were to be reserved to the non-utility accounts of the Company and would not be subject to regulation. The shareholders have long understood that they were not entitled to the same price as were their competitors in the field for natural gas discoveries because of the exploration expense in the rates. But as to other oil and liquid hydrocarbon discoveries, such have been treated separately in the non-

utility accounts of MOUNTAIN FUEL and the shareholders were entitled to revenues of a sale at market, for said non-utility product. The ratepayers were entitled to lower than market price gas at the cost of service in consideration for the exploration expense in the rates. The conceptual, practical, and accounting aspects of this program has been beneficial to MOUNTAIN FUEL's customers, to its shareholders, and to the Company, itself. Exploration and development has placed MOUNTAIN FUEL in a position of being one of the strongest distribution utility companies in the United States with respect to dedicated gas reserves and the price of gas supply. The successes achieved in recent years in non-utility oil discoveries have benefited both the utility customer through a lowering of the cost of capital, *P.S.C. Case No. 7113(II)* (December 1975), and the shareholders through a return upon investment. Based on all of the evidence and arguments in this Case, we find that it would be unfair, unwise and improvident to the customers, to the shareholders, and to the Company to depart from the basic principles of the program by retroactively attempting to change or undo that which has already transpired.

THE WEXPRO AGREEMENTS

47. WEXPRO COMPANY was created in late 1976. Company witnesses Kastler, Crawford, Kirsch, Cash and Sanders all testified that WEXPRO was created primarily for two purposes: first, to provide and maintain a vigorous exploration program to enable MOUNTAIN FUEL to secure natural gas reserves for the future and second, to remove regulatory uncertainty from non-utility oil properties and assets of MOUNTAIN FUEL. Following the January 14, 1974, Order of the Commission in *P.S.C. Case No. 6668,* MOUNTAIN FUEL underwent such financial disorder that this Commission was required to reverse the merger aspects of such Order on January 21, 1974 to protect the financial integrity of the Company. In *P.S.C. Case No. 7113* in 1975, protestants challenged the traditional treatment of non-utility oil properties seeking equitization of such properties with the consequent result that natural gas rates would be decreased. Thereafter, in 1976, MOUNTAIN FUEL was involved in a proxy battle for control of Company management which resulted from dissatisfaction on the part of certain shareholders with the protection management had provided for the non-utility investment. Consultation by management with shareholders, investment bankers, security analysts, and other financial advisers indicated that capital could not be attracted at reasonable cost in order to further continue strong exploration and development under the existent conditions. Necessary preparations were finalized in the latter part of 1976 and it was determined that WEXPRO should be created as a wholly owned subsidiary, that the non-utility oil properties of MOUNTAIN FUEL should be transferred to it and that it should engage in joint exploration activites with MOUNTAIN FUEL on the same fundamental bases that existed between the utility and non-utility accounts prior to the creation of WEXPRO. The plan was implemented by the incorporation of WEXPRO and the execution of the Agreement of Purchase and Sale and the Joint Exploration Agreement dated December 21, 1976, between MOUNTAIN FUEL and WEXPRO.

Agreement of Purchase and Sale.

48. The Agreement of Purchase and Sale dated December 21, 1976, between MOUNTAIN FUEL and

WEXPRO (MFS Ex. 1) transfers all of the properties held in MOUNTAIN FUEL's non-utility oil account as of December 31, 1976 to WEXPRO effective January 1, 1977 in consideration for all of the outstanding stock of WEXPRO. The assets were transferred at depreciated book value in exchange for WEXPRO stock at par value. The Agreement reserves to MOUNTAIN FUEL ownership of all significant natural gas reserves on the transferred properties which had been discovered prior to the date of transfer. MOUNTAIN FUEL is granted the option to purchase, on a right of first refusal, all new natural gas discovered and developed by WEXPRO on the transferred properties forever and a ten-year right of first refusal to purchase gas discovered by WEXPRO on properties acquired by WEXPRO after January 1, 1977 in an eight state area. The Agreement was amended on January 1, 1977 (MFS Ex. 1A) to provide that the option to purchase gas discovered on properties acquired by WEXPRO after January 1, 1977, would be subject to renegotiation for an additional ten-year period.

Joint Exploration Agreement.

49. The Joint Exploration Agreement dated December 21, 1976, between MOUNTAIN FUEL and WEXPRO (MFS Ex. 2), was designed to continue as nearly as possible after January 1, 1977, the relationship between the utility and non-utility divisions of MOUNTAIN FUEL which existed prior to that date. It provides that MOUNTAIN FUEL and WEXPRO each pay one-half of the total exploration expenses of $6,240,258 per year for lease and land acquisition, holding and disposition costs, geological, geophysical and related personnel costs, non-productive drilling costs and other expenses incidental to exploration activities on joint exploration acreage after

1976. The Agreement provides that if a well is completed under the Agreement the product from the well is gauged for a period of 30 days to be valued in terms of oil and gas at the then prevailing market value for oil and gas of similar quality and vintage. If the dollar value of gas produced exceeds the dollar value of the oil produced, the well is capitalized in the utility accounts of MOUNTAIN FUEL and MOUNTAIN FUEL reimburses WEXPRO for its expenses in drilling the well. Leases and land logically related to the well are retained by MOUNTAIN FUEL and WEXPRO is entitled to purchase any incidental oil produced from that well on a right of first refusal basis. If the greater value of production is oil rather than gas, then the costs related to such well are capitalized in the accounts of WEXPRO and WEXPRO reimburses MOUNTAIN FUEL for its drilling expenses. Leases and lands logically associated with the well are transferred to WEXPRO and MOUNTAIN FUEL has a right of first refusal to purchase incidental gas from such well at market price. Under the Agreement, MOUNTAIN FUEL has the option of avoiding its contribution to drilling costs by farming out its interest to WEXPRO or to other parties. A development well drilled as an offset to an initial oil discovery well is still under the terms of the Agreement and if non-productive, the expenses of such well are shared equally by MOUNTAIN FUEL and WEXPRO. However, a development well drilled as an offset to an initial oil discovery well does not fall under the terms of the Agreement and whether productive or non-productive, such well is paid for entirely by WEXPRO. The Joint Exploration Agreement was also amended on January 1, 1977 (MFS Ex. 2A) to clarify the right of first refusal granted the parties under it.

Well Operating Agreement.

50. On January 1, 1977, MOUNTAIN FUEL and WEXPRO entered into a Well Operating Agreement (MFS Ex. 3) which provided for the operation by MOUNTAIN FUEL of certain WEXPRO wells and WEXPRO of certain MOUNTAIN FUEL wells for the convenience of the parties. This Agreement was amended on June 1, 1977, (MFS Ex. 3A) to designate the operator on certain of the wells owned by the Companies.

MOUNTAIN FUEL's Alternate Proposal.

51. On August 23, 1977, the Commission ordered MOUNTAIN FUEL to present an alternate proposal on Rehearing modifying the terms and conditions of the Purchase and Sale Agreement and the Joint Exploration Agreement between MOUNTAIN FUEL and WEXPRO which had been the subject of negotiated discussions between counsel for the parties. As outlined to the Commission in the August 23, 1977 hearing, the thrust of the discussion between counsel was that with respect to both transferred acreage and joint exploration acreage, all natural gas would be owned by MOUNTAIN FUEL and all other oil hydrocarbon would be owned by WEXPRO, each at the cost of service of production.

52. While the Commission has determined that it does not have jurisdiction over the non-utility properties transferred by MOUNTAIN FUEL to WEXPRO for reasons stated in the July 20 and August 29, 1977 Reports and Orders, it does have jurisdiction to review and approve contracts entered into by MOUNTAIN FUEL with respect to utility functions of the Company and to disapprove the same in one or more parts if it finds any such utility contract to be unjust, unreasonable, or not in the public

interest. 54-4-4(2) U.C.A. 1953 as amended. Without finding that the existent Purchase and Sale Agreement and the Joint Exploration Agreement were unjust or unreasonable, on August 23, 1977, the Commission did believe it to be in the public interest to set down on Rehearing a review of the alternate proposal to determine the nature, character and public interest aspects of the same. On rehearing, MOUNTAIN FUEL submitted the alternate proposals reduced to writing in the form of MFS Exs. 4 and 5, the primary elements of which were the following:

(1) *Alternate Agreement of Purchase and Sale, MFS Ex. 4.*

(i) The Weber Formation at Brady was reserved to the ownership of MOUNTAIN FUEL at blowdown after reimbursement to WEXPRO for the depreciated book value of the Weber wells used by MOUNTAIN FUEL. Reservation of ownership in gas reserves to MOUNTAIN FUEL developed by utility wells at Brady, Spearhead Ranch, Dry Piney, and Birch Creek, were also set out. Such provisos were also set forth in the executed Purchase and Sale Contract;

(ii) MOUNTAIN FUEL reserved all natural gas on the transferred acreage and wells at the cost of service, except for that gas needed by WEXPRO for pressure maintenance or field operations;

(iii) A cost of service definition was included for gas produced from facilities owned by WEXPRO which would include, in general, the cost of production including all depreciated original cost investment on the average value ratio of gas to oil produced over the preceding 12 months, together with a rate of return component permitted by this Commission on utility property of MOUNTAIN FUEL. Other aspects of the cost of service definition need not be mentioned specifically here;

(iv) The classification of product as "gas" or "oil" rested upon a definition in which gas was defined as marketable natural gas after removal of heavier hydrocarbons and non-hydrocarbon components, and oil was defined as all other hydrocarbons whether existent in liquid phase after separation or separated from the gas steam; and

(v) The witness Kastler also testified that under the alternate Agreements, the gas producing properties located on the west slope of the Rocky Mountains in Colorado which had been in the non-utility account of MOUNTAIN FUEL on December 31, 1976, because of the unavailability of the gas to MOUNTAIN FUEL's system, would be retransferred to MOUNTAIN FUEL as would other non-utility gas properties which had been in the non-utility account under similar circumstances.

(2) *Alternate Joint Exploration Agreement (JEA), MFS Ex. 5.*

(i) Each party would contribute $3,120,129 per year to joint exploration expense;

(ii) Said joint exploration expense would be available for wildcat dry holes and associated expenses, delay rentals, abandoned leases, and other non-productive well drilling on JEA acreage including MOUNTAIN FUEL utility gas development wells. The joint exploration expense funds would not be available for wildcat exploration on the transferred acreage or upon development oil acreage transferred to WEXPRO under the Joint Exploration Agreement;

(iii) A discovery well would be classified as either oil or gas based upon the value of production for a 30-day test period. Such 30-day test did not vary from the original executed accords;

(iv) If the well were declared gas, MOUNTAIN FUEL would own the same and would capitalize all costs associated with the well in its capital utility account. All natural gas would

come to MOUNTAIN FUEL from said well at cost, and all oil production from said well would be reserved to WEXPRO at the cost of producing the same;

(v) If the well were declare to be oil, WEXPRO would own the same and would capitalize all costs associated with the well in its capital account. All oil would come to WEXPRO from said well at cost, and all gas production from said well would be reserved to MOUNTAIN FUEL at the cost of producing the same;

(vi) A definition of the cost of service, identical to that of the alternate Purchase and Sale Agreement, was included;

(vii) A written definition of gas and oil was also set out identical to that in the alternate Purchase and Sale Agreement; and

(viii) The policy witness Kastler, for MOUNTAIN FUEL testified that MOUNTAIN FUEL interpreted the alternate Joint Exploration Agreement to provide that if a well were classified as an oil well and acreage were transferred to WEXPRO, any gas subsequently discovered on such acreage would come to MOUNTAIN FUEL at cost of service whether from an oil or a gas well.

53. The thrust of the alternate proposal was that because of the specifically identifiable interest of MOUNTAIN FUEL in securing new dedications of natural gas on the one hand, and the specific interest of WEXPRO in exploring for oil and other liquid hydrocarbons, as well as securing gas reserves for MOUNTAIN FUEL on the other hand, all gas produced on the transferred or joint exploration acreage exclusive of lease use would go to MOUNTAIN FUEL at cost of service and all other oil and liquid hydrocarbon discoveries would go to WEXPRO at the cost of service.

PROPOSALS OF DIVISION OF PUBLIC UTILITIES

54. The Division and other Protestants attempted to demonstrate on cross-examination of MOUNTAIN FUEL's witnesses and through their own witnesses, that the executed Agreements and alternate proposals of MOUNTAIN FUEL were unfair and not in the interest of the utility ratepayer. The essence of their position was that the Agreements and proposals were not arms length as one would find typically in the oil and gas industry, that there was not an evenhanded sharing of risks and benefits, that the commonality of officers and ownership of MOUNTAIN FUEL and WEXPRO created irreparable conflicts of interest and that the Agreements would make it more difficult and costly for MOUNTAIN FUEL to attract new capital.

55. Dr. Daniel M. Bass of the Colorado School of Mines, testified that drilling to increased depths could be expected in the future in Wyoming, Colorado and Utah; that while it was impossible to specify, the deeper formations would generally tend to produce more gas condensates; that MOUNTAIN FUEL would improve its position if it were to farm-out all of its joint exploration acreage rather than perform the WEXPRO agreements, executed or alternate; that generally speaking, methane gas was not of sufficient BTU content for marketable pipeline quality; and that the call on natural gas produced on WEXPRO properties acquired after January 1, 1977, was without any value absent some specific acreage requirement. The witness acknowledged the intense competition for new gas discoveries in MOUNTAIN FUEL's historic areas of exploration development and that much activity was stimulated by natural gas distribution

utilities in the mid-west and southwest who advanced millions of dollars of front money to exploration companies for a call on gas discovered on wildcat acreage. He also stated that many natural gas utilities, active in the Rocky Mountain area, conduct exploration and development for natural gas through wholly owned subsidiary corporations.

56. The Division submitted essentially two proposals counter to those of MOUNTAIN FUEL, one through Dr. Bass and the other through the Division Director, Eugene S. Lambert. As to the transferred properties and acreage to WEXPRO from MOUNTAIN FUEL, it was Dr. Bass's recommendation that the Commission should not disturb the same but should let it stand. The essential elements of the Bass and Division proposals were:

(1) *Bass Proposal.*

Dr. Bass did not submit a formal suggestion as to an arrangement for joint exploration between MOUNTAIN FUEL and WEXPRO. However, he did testify that as a general concept, an acceptable proposal would be an even split of all expenses, cost and hydrocarbon discoveries. After cross examination and under questioning by the Commission, Dr. Bass submitted a proposal assuming that all natural gas discoveries under the Joint Exploration Agreement would be owned by MOUNTAIN FUEL and that all oil and other liquid hydrocarbons would be owned by and go to WEXPRO, to-wit:

(i) MOUNTAIN FUEL would place all leasehold acreage under joint exploration, reserving to it the ownership of proven reserves of natural gas, gas condensate and gas liquids;

(ii) MOUNTAIN FUEL would be entitled to sell any of the acreage under the JEA prior to January 1, 1980 and to receive all proceeds from sale without obligation to WEXPRO for

replacement;

(iii) If MOUNTAIN FUEL were to sell JEA acreage after January 1, 1980, the proceeds from said sale would be divided equally between MOUNTAIN FUEL and WEXPRO with neither party obligated to secure replacement acreage;

(iv) WEXPRO would pay all exploration and dry hole expenses for five years in excess of the exploration expense approved by the Public Service Commission with a ceiling of 6 million dollars. After January 1, 1982, MOUNTAIN FUEL and WEXPRO would contribute expense funds equally to exploration;

(v) Prior to January 1, 1982, WEXPRO would be required to purchase at its own acquisition costs, 1 million acres of oil and gas leases in Colorado, Utah and Wyoming to be included in the JEA acreage. Transferred acreage could not be used to meet the 1 million acre obligation;

(vi) In addition, WEXPRO would be required to purchase at its own acquisition costs 2 million acres of oil and gas leases in Colorado, Utah and Wyoming prior to January 1, 1987, upon which MOUNTAIN FUEL would have a first call on all natural gas developed thereon;

(vii) Field use of natural gas in producing hydrocarbon products would be credited to MOUNTAIN FUEL as a sale, as would flared or vented gas in the operation of a producing well, at the highest royalty price;

(viii) MOUNTAIN FUEL would have sole authority to determine whether separator gas is processed in a natural gas processing plant with MOUNTAIN FUEL receiving all revenues therefrom;

(ix) MOUNTAIN FUEL would determine whether separator gas would be used for pressure maintenance in the reservoir and if so, gas would come to MOUNTAIN FUEL at blowdown at no

expense. If so used, MOUNTAIN FUEL, in addition, would be entitled to a rental payment not less than the current rate of return authorized by this Commission on the market value of the gas;

(x) As to any producing well, MOUNTAIN FUEL would own all separator gas and WEXPRO would own all separator liquids in a storage tank or discharged from a LACT unit;

(xi) The operating cost of a producing well would be prorated upon a ratio of the value of separator gas to the value of stock tank liquids based upon the price paid the royalty owner;

(xii) An independent appraisal would be made within six months after a well is classified to determine allocated separator gas and stock tank liquids with the capital costs allocation of the well based on the ratio of the undiscounted value of the separator gas and stock tank liquid reserves, using current royalty prices for each product.

(2) *Lambert Proposal for the Division.*

The final Division witness was its Director, Eugene S. Lambert, who submitted to the Commission the Division proposal for a joint exploration and development agreement between MOUNTAIN FUEL and WEXPRO. Mr. Lambert testified that such proposal was "comprehensive" and "not subject to the acceptance of some points and rejection of others". There were three elements that any exploration and development arrangement between the two Companies must encompass, the witness said: (1) "a parity of risks and benefits"; (2) not even the potential of a "conflict of interest between parent and subsidiary"; and (3) a sound exploration and development program for MOUNTAIN FUEL. The witness then stated the comprehensive Division proposal for contractual agreements between MOUNTAIN FUEL and WEXPRO:

(i) A complete review of every property transferred to WEXPRO by MOUNTAIN FUEL as

of January 1, 1977 would be required to determine whether the transferred assets were accurately classified as non-utility holdings, assuming without admitting that MOUNTAIN FUEL's classification system was fair, equitable and appropriate;

(ii) As to the transferred acreage, MOUNTAIN FUEL would have a right to all natural gas produced at cost of service as contrasted to the regulated field price, whether such gas is developed before transfer by the non-utility account or after transfer to WEXPRO;

(iii) As a credit against the cost of service natural gas sold on the transferred acreage, MOUNTAIN FUEL would be entitled to a credit for all field use, and venting or flaring of gas, such credit to be measured at the highest royalty price in the field, even though such venting, flaring or field use was directly related to the development of a WEXPRO gas well, the product of which would go to MOUNTAIN FUEL at cost of service;

(iv) As a further credit against the cost of service natural gas sold to MOUNTAIN FUEL by WEXPRO, MOUNTAIN FUEL would be entitled to all the net revenues on the transferred acreage from the sale of natural gas liquids as if MOUNTAIN FUEL were the sole owner thereof. Such would be the case even though WEXPRO or the predecessor non-utility account had paid for all expenses and capital cost then associated with the production of such gas liquids;

(v) If the credits from the gas liquids revenues and from flaring, venting and field use of natural gas on the transferred acreage exceeded the cost of service price for gas delivered by WEXPRO to MOUNTAIN FUEL in any given year, MOUNTAIN FUEL would be entitled for that period to all cost of service gas without any charge and a reimbursement by cash or other credit to be paid over by WEXPRO to MOUNTAIN FUEL for the excess;

(vi) MOUNTAIN FUEL would be barred from spinning off any WEXPRO common stock at all, and from disposing by any other method more than one-third of the then outstanding shares of WEXPRO common equity;

(vii) As to new leasehold acreage acquired by WEXPRO that is not held in the Joint Exploration Agreement with MOUNTAIN FUEL, MOUNTAIN FUEL would have a firm 20-year option on all natural gas discoveries thereon extending through January of 1997;

(viii) As to the Joint Exploration Agreement, such contract must provide the following conditions:

(a) Both MOUNTAIN FUEL and WEXPRO are to contribute one-half of all expenses incident to acreage maintenance and non-productive well drilling;

(b) MOUNTAIN FUEL shall retain an "exclusive right" to make farm-out arrangements with third parties on all joint exploration acreage, regardless of the desire of WEXPRO to drill any of such holdings;

(c) All JEA acreage shall be listed in the ownership of MOUNTAIN FUEL with no transfer of the same to WEXPRO;

(d) WEXPRO would be barred from acquiring any leasehold acreage in the States of Wyoming, Colorado and Utah that is not part of the JEA;

(e) Prior to January 1, 1987, WEXPRO must acquire at its own expense and transfer to MOUNTAIN FUEL, to be owned by the latter, 1 million net working acres of oil and gas leaseholds, said properties to be located in Wyoming, Colorado and Utah;

(f) All unexplored formations at the Brady Unit of WEXPRO in southwestern Wyoming shall be subject to the Joint Exploration Agreement;

(g) WEXPRO shall be required to pay to MOUNTAIN FUEL or at least provide a guaranteed payment of $15 million to fund a special exploration account of MOUNTAIN FUEL;

(h) All hydrocarbons discovered, whether oil or gas, under the Agreement shall be shared equally between MOUNTAIN FUEL and WEXPRO, with MOUNTAIN FUEL having a call on all of WEXPRO's share of natural gas at the market price. WEXPRO shall not have a call on MOUNTAIN FUEL's shares of the oil;

(i) The revenues from MOUNTAIN FUEL's share of liquid hydrocarbon discoveries shall be credited to the cost of service natural gas charged MOUNTAIN FUEL utility customers to the extent of the annual exploration and development expense, with the remaining earnings from such hydrocarbon discoveries providing cover to maintain and restore, if needed, the $15 million special exploration account. After full offset of the annual exploration expense of MOUNTAIN FUEL and maintenance of the $15 million exploration account, any remaining net revenues from MOUNTAIN FUEL's share of the liquid hydrocarbons shall be available to the shareholders as Company earnings.

It was the intent of the Division, as expressed by Mr. Lambert, that through the proposal submitted, there would never again be required an exploration expense reflected in the utility rates and charges of MOUNTAIN FUEL for the sale of natural gas in the State of Utah of Company production.

57. Mr. Lambert allowed that if the Division proposal were not acceptable in whole, the specific proposal of Dr. Bass would be his second option, and if the latter were not adopted, the existing Purchase and Sale Agreement and Joint Exploration Agreement between MOUNTAIN FUEL and WEXPRO would be preferable to no exploration program. He stated that he could not approve a return to the exploration activites of MOUNTAIN FUEL in its utility gas and non-utility oil divisions prior to January 1, 1977.

Response of MOUNTAIN FUEL and WEXPRO to Division Proposals.

58. The primary proposal of the Division as well as that of Dr. Bass drew concern from MOUNTAIN FUEL and also WEXPRO on cross-examination. It was urged by MOUNTAIN FUEL that in dividing hydrocarbon discoveries equally rather than on the basis of the regulated utility product to MOUNTAIN FUEL and the non-regulated, non-utility product to WEXPRO, the propositions missed the corporate objectives of MOUNTAIN FUEL in the creation of WEXPRO, namely, to secure new gas reserves for MOUNTAIN FUEL at a reasonable cost and to permit the shareholders of MOUNTAIN FUEL to otherwise earn competitive market prices for other hydrocarbon discoveries and sales. It was urged that since the Division proposition would place MOUNTAIN FUEL even more directly, than before WEXPRO, in the non-utility oil business, such proposal would not eliminate the regulatory uncertainty surrounding such production, but rather would tend to intensify the same. It was further claimed by MOUNTAIN

FUEL and WEXPRO that the Division proposal attempted to treat WEXPRO and MOUNTAIN FUEL at arms length and as competitors against each other when, as a wholly owned subsidiary of MOUNTAIN FUEL, WEXPRO was intended to complement and add to MOUNTAIN FUEL's own exploration program. It was additionally argued that the acreage contribution required of WEXPRO was an arbitrary quantification which could very well be without any value to a joint exploration arrangement, and that the extension of the 10-year call to a 20-year call on all gas discoveries of WEXPRO outside of the JEA would unduly restrict the ability of WEXPRO to enter into exploration partnership and arrangements with other ownership interests and operators in the Field. MOUNTAIN FUEL also contended that the requirements of payment for field use of gas were not consistent with industry practice and were unreasonable under circumstances wherein MOUNTAIN FUEL had no investment in the properties producing the associated gas, such investment having been made by WEXPRO. The evidence was uncontested that royalty interest holders are not paid royalties on lease use fuel and such use is not considered a sale.

59. It was further alleged by MOUNTAIN FUEL that the Division proposals were unrealistic and unworkable. The provisions barring MOUNTAIN FUEL from the spin-off of any WEXPRO stock or from the public sale of more than one-third of common equity, would present serious problems of capital financing on the part of both MOUNTAIN FUEL and WEXPRO. Franklin D. Sanders, Vice President of the First Boston Corporation of New York City, testified on Rebuttal that not only the bar against spin-off and sale create difficulties, but that the proposed treatment of the gas liquids on the transferred

properties of WEXPRO, as though MOUNTAIN FUEL were the owner thereof, would preclude the sale of MOUNTAIN FUEL equity and debt securities in the market on reasonable terms. Sanders further testified that it would be a literal impossibility for WEXPRO to make a $15 Million payment or credit to MOUNTAIN FUEL in the foreseeable future, as proposed by the Division, and that WEXPRO would not be able to conduct reasonable long-term financing through the sale of capital securities. Further, although the Division maintained that its proposal was not intended to punish or penalize WEXPRO for the alleged unfairness of the exploration and development program of MOUNTAIN FUEL prior to the creation of WEXPRO, nonetheless, Mr. Lambert and Mr. Norman both acknowledged that the provisions of acreage acquisition and contribution to Joint Exploration by WEXPRO and the $15 Million front money payment to MOUNTAIN FUEL by WEXPRO were inserted because of what they perceived to be previous inequities in the MOUNTAIN FUEL exploration activities prior to January 1, 1977.

60. As to the requirement of the Division that there be a property by property review and classification as non-utility of all assets transferred to WEXPRO, MOUNTAIN FUEL urged that the Division, under its July 1, 1977 Report to this Commission, (MFS Ex. 18) had already stipulated as to the accuracy of the classification under MOUNTAIN FUEL's system by the statement:

> "It [the Division] also concludes that the assets transferred [by Mountain Fuel to Wexpro] are non-utility assets as presently defined by the Company."

Mr. Lambert did in fact verify the accuracy of Exhibit 18 by his testimony that the Division's intent in the July 1

Report was to declare that the conducted audit reflected the transferred properties to be of non-utility character according to the Company's "accounting methods and classification methods." (Tr. 2297). Mr. Lambert did confirm the fact that the July 1, 1977 Report to the Commission on the WEXPRO transfer was transmitted with his knowledge and concurrence as Director of this Division.

FARM-OUT PACKAGES

61. It was the view of Dr. Bass, that weighed against the existent and alternate MOUNTAIN FUEL—WEXPRO Agreements hereinabove discussed, MOUNTAIN FUEL would be to the better if it were to contract with independent third parties with respect to its wildcat acreage under what is known in the oil and gas industry as "farm-out" arrangements. A typical farm-out agreement contemplates that the owner (in this case MOUNTAIN FUEL) of wildcat, unexplored acreage, assembles together a package of such properties to be drilled by a third party. The front money for drilling operations is advanced by the third party who assumes all of the initial risks of nonproductive well-drilling in return for the acquisition of an interest (usually one-half) in the farm-out acreage. If a discovery is made on the acreage drilled, the third party is normally entitled, from the initial net revenues of production, to reimbursement or a "pay-out" of all of his expenses and capitalized costs in the well before the acreage owner is entitled to any return. After pay-out to the operator, the net revenues from all production are thereafter divided between owner and operator (commonly in equal proportions) with the operator receiving one-half of the drilled acreage. Dr. Bass referred

to a farm-out as an arrangement between "a pessimist (the owner) and an optimist (the operator)."

62. It was the position of Dr. Bass that because of the intense competition and activity in the Rocky Mountain Area with respect to oil and gas exploration, numerous companies would be interested in drilling all of MOUNTAIN FUEL's unexplored acreage under an arrangement or arrangements in which the Company could in addition to its share of gas discoveries retain a call on the operator's share, and would still never have to surrender more than one-half of its acreage holdings. Dr. Bass cited Pennzoil, Houston Oil & Gas Company, Highland Resources, Inc., and others as probable and potential operators of a MOUNTAIN FUEL Farm-Out Package. R. D. Cash, Vice President of Exploration and Drilling of MOUNTAIN FUEL, took exception on Rebuttal to the conclusions of Dr. Bass with respect to the realistic potential of a MOUNTAIN FUEL farm-out of its unexplored acreage. In relying upon his exploration experience with MOUNTAIN FUEL and Amoco Production Company in the Rocky Mountain Area, he stated that farm-out packages of major significance were difficult to put together under current conditions in the natural gas industry. It is unlikely, according to Mr. Cash, that the owner of farm-out acreage would be able to obtain a call on the operator's share of any gas find. Such was the case because many exploration companies are searching for natural gas in the vicinity of MOUNTAIN FUEL's holdings in the Rockies on behalf of midwest and southwest distribution utilities. Such distribution utilities are interested in only pipeline quality gas and not in securing other and heavier liquid hydrocarbons.

63. With respect to farm-out packages of the nature suggested by Dr. Bass, Mr. Cash testified that MOUNTAIN FUEL had attempted to market a major farm-out from mid-1976 through mid-1977. The specific package under negotiation, set forth in MFS Ex. 22, was a proposal for a third party or parties to acquire a 50% working interest in 106,000 acres of unexplored leases by drilling 17 wells to varying formations in 15 different fields at an estimated cost of $17-$20 Million over a two year period. MOUNTAIN FUEL contracted to retain a call on the operator's share of the gas discovered at market price. The proposal was shown by MOUNTAIN FUEL in 1976 and the forepart of 1977 to some 18 companies who were conducting exploration activities in the affected states and being unable to find a willing operator or consortium of operators to take the farm-out package, authorized an exclusive agent, McCormick Oil and Gas Company, to obtain an operator which it was anticipated would be a partnership between McCormick and one or more others. The package was shown by McCormick to some 40 companies including Pennzoil, Houston Oil and Mineral Company, Highland Resources, Inc., along with parties Cities Services Gas Company (a gas distribution utility), Tenneco, Mobil, Champlin, Shell Oil Co., Exxon, Gulf Oil Co., and Continental Oil Company. (MFS Ex. 23). Mr. Cash concluded that the package could not be marketed successfully for at least two reasons: first, each operator or consortium wished to pick and choose the better known properties instead of being willing to undertake exploration upon the entire package; and second, MOUNTAIN FUEL requested a call on the operator's share of the gas discoveries. While Exhibits 22 and 23 are not conclusive on the potentiality and advisability of farm-

out arrangements by MOUNTAIN FUEL, they are probative of the problems MOUNTAIN FUEL might expect to encounter if it were to undertake a massive arrangement on its unexplored acreage.

64. There are additional reasons under the evidence which suggest a cautious approach to any wholesale farm-out of MOUNTAIN FUEL's unexplored acreage. The Company has long been known as one of the strongest gas exploration interests in the Rocky Mountain Area, having a strong exploration department and possessing a sound record of successful gas discovery. Farm-out arrangements, by their nature, are uncertain and speculative and as indicated by Dr. Bass, are generally put together by an owner who is either under-capitalized or has a low regard of the acreage potential and by a buyer who believes that the acreage has adequate potential to justify the risk of exploration. A massive farm-out program at MOUNTAIN FUEL might well result in the sacrifice of its best acreage and retainage of its worst in order to attract potential operators. As one of the front-runners of gas exploration in the Rocky Mountains, MOUNTAIN FUEL should be encouraged to explore under circumstances where it may retain a call on the gas discoveries made in order that it may continue to dedicate new finds to its own future reserves.

Conclusion on Farm-Out Arrangements.

65. In consideration of all the evidence before the Commission on the question of whether farm-out arrangements would be a viable alternative to a joint exploration agreement between MOUNTAIN FUEL and WEXPRO, we find that it is improbable under current competitive conditions in the Rocky Mountain Basin that MOUNTAIN FUEL could retain a call on the operator's

share of gas discovered and that for reasons heretofore set out above, it would be unreasonable, impractical, and contrary to public interest to require that MOUNTAIN FUEL farm-out its unexplored wildcat acreage rather than continue to perform its Joint Exploration Agreement with WEXPRO. Under the latter Agreement, MOUNTAIN FUEL maintains a call on all natural gas discovered and under the Findings which are set forth in this Order such will come to MOUNTAIN FUEL's distribution system at the cost of service. *This conclusion is reached without any intention of foreclosing or discouraging MOUNTAIN FUEL from entering into farm-out arrangements of its representative interest in joint exploration acreage, should the Company determine such to be feasible and in its best interest, or from a future farm-out of joint exploration acreage, itself, should such be advantageous to the Company. However, the specific elements of any farm-out arrangement between MOUNTAIN FUEL and a third party or WEXPRO should be spelled-out with particularity in the farm-out agreement, itself, so that the same may be clearly understood.*

DISCOVERY PROSPECTS OF DEEP DRILLING

66. The testimony was not at variance in the Proceeding that the greater majority of the shallow formations in the Rocky Mountain Area already had been the subject of exploration and development and that the productive finds in the future would entail deep zone drilling. MOUNTAIN FUEL regarded deep drilling on its system as being in the area of 13,000 feet beneath surface level and below, whereas the Division witness, Dr. Bass, referred to deep drilling as that below 9,000 feet (the latter being the average drilling depth in the United states during 1976). MOUNTAIN FUEL is presently engaged in

exploration or production at Kinney, Church Buttes and Butcherknife Gas Fields at depths ranging from 14,000 feet to 18,000 feet with drilling taking place by other operators in neighboring fields at the same depths.

67. Testimony was not in dispute that as drilling was conducted at lower formations, the discoveries would more likely be gas and less likely liquid in the reservoir, but there was a difference of opinion among the experts as to what form the hydrocarbons in such discoveries would take at the surface. Dr. Bass expressed the judgment that dependent upon the particular formation and the age thereof, gas in the condition of condensates and liquids could be expected and that notwithstanding the gaseous state of the hydrocarbons of the reservoir it was possible that through lifting and production processes at the well, the product at the surface would have a greater value of oil than gas under the definition of MOUNTAIN FUEL. One of the factors upon which Dr. Bass placed reliance was Division Ex. 16 which sets forth new discoveries of MOUNTAIN FUEL between 1972 and 1976 and indicated, based upon current market prices, that the value of new oil reserves discovered exceeded the value of new gas reserves by approximately one and one-half times. Dr. Bass stated that if the Brady Field, discovered by Champlin in 1973, were removed from the discoveries set out in Division Ex. 16, the value of new gas discoveries would exceed the value of new oil discoveries during the years 1972 through 1976 by three times. Dr. Bass acknowledged that the Brady Field was unique in the Rocky Mountain Basin and to MOUNTAIN FUEL, so much so that he could not identify another field like it in all of Wyoming, Colorado and Utah. As to other fields besides Brady in southwest Wyoming, Dr. Bass was unable to identify any

field in the Rocky Mountains which had been successfully drilled at depths in excess of 14,000 feet wherein the value of oil production exceeded the value of gas production, as those terms are defined in the alternate Agreements of MOUNTAIN FUEL, MFS Exs. 4 and 5.

68. MOUNTAIN FUEL witnesses Cash and Laurance Reid, Professor Emeritus of Petroleum Engineering at the University of Oklahoma, both testified that deep zone drilling in the Rocky Mountain Basin would be more likely to yield natural gas finds than liquid hydrocarbons or condensates, both as a matter of geophysical theory and empirical observation. Professor Reid relied upon a published article in the *Petroleum Engineering Journal*, MFS Ex. 10, which states that methane would normally be expected as a discovery product in the deepest and oldest sediments. Both witnesses Cash and Reid cited examples of 10 deep drilled fields recently developed in the Rocky Mountain Basin in which gas production, as defined by MOUNTAIN FUEL, predominated over oil production. Such fields included Bruff, Hogback, Natural Buttes, Kinney, Church Buttes, Moxa Arch, Shell Creek, Wamsutter, Butcherknife and Table Rock in the States of Wyoming and Colorado. Professor Reid also took exception to the Statement of Dr. Bass that methane gas did not meet ordinary quality standards of pipeline natural gas and required enrichment. It was testimony of Reid that pure methane has a BTU reading of 1012 per Mcf. The evidence does demonstrate that such a BTU level qualifies as pipeline natural gas under standards established by the Federal Power Commission.

Conclusion on Deep Drilling.

69. Based upon the testimony before us, we find that it is not necessary to reject the existent or alternate

Agreements of MOUNTAIN FUEL or to accept the Division's proposal on the premise that gas or oil, as historically defined by MOUNTAIN FUEL, is likely to preponderate over the other. We expect and will require that MOUNTAIN FUEL, and assume, as well, that WEXPRO, in the performance of the Joint Exploration Agreement as suggested in this Order, will exercise good faith and utilize sound practices in the oil and gas industries in the development and management of oil and gas discoveries. Accordingly, it is unnecessary to reject MOUNTAIN FUEL-WEXPRO Agreements on the basis that the value of production of oil and condensates, as defined by MOUNTAIN FUEL, are more likely to be the subject of discovery in the future.

ABILITY OF MOUNTAIN FUEL AND WEXPRO TO CONDUCT CAPITAL FINANCING

70. The capacity of a public utility, whose utility functions are subject to the jurisdiction of this Commission, to undertake capital financing in the security markets is of considerable significance to the Commission. Utility customer rates increase, utility services deteriorate, and the public interest suffers when a capital intensive public utility is unable to satisfactorily finance its capital expenditures in the country's financial markets. We are cognizant of resultant problems facing a utility and its management when its common equity stock is unable to be traded and when it cannot carry forth the sale of equity or debt securities on a sound and favorable basis. *P.S.C. Case No. 6668* (January 21, 1974 and July 18, 1974). While the ability of a public utility to finance its capital expenditures through the sale of public securities is not a factor that should control the disposition of every issue at all times before this Commission, it is a question which, in

the essence of public utility regulation, is entitled to considerable weight.

71. MOUNTAIN FUEL has maintained throughout these Proceedings that until the issues which have been raised by the Protestants regarding the WEXPRO transfer in this Case have been settled and approved, it is unable to market either its equity or debt securities. The Company had intended to undertake the sale of a common equity issue of $20 Million during the summer of 1977 in order to strengthen and balance the capital structure of the corporation, as well as to provide needed funds for meeting 1977 capital expenditures. The testimony is uncontested that MOUNTAIN FUEL has been unable to market such equity issue because of the pendency of this Case.

72. The evidence is further without contest that the corporate subsidiary of MOUNTAIN FUEL, WEXPRO, also cannot engage in any capital financing until the issues surrounding the transfer of assets to it by MOUNTAIN FUEL have been resolved. WEXPRO argues that it must undertake financing through the sale of its capital securities in order for it to undertake a strong and progressive development and exploration program and to fully perform its responsibilities under the Joint Exploration Agreement with MOUNTAIN FUEL. While the ability of WEXPRO to engage in capital financing is not of direct concern to this Commission, it is important that if WEXPRO is to carry out its role under the joint exploration arrangements with MOUNTAIN FUEL, it be in a sound financial position to do so.

73. The testimony from the senior management of MOUNTAIN FUEL and WEXPRO is that both Companies can conduct favorable equity and debt financing upon

conclusion of this Case, as it relates to the transferred assets to WEXPRO, and that such can be accomplished under the Joint Exploration Agreement now in existence or under the alternate proposal. On the other hand, it is uncontested testimony through Mr. Sanders of the First Boston Corporation that MOUNTAIN FUEL could not conduct capital financing on any reasonable basis if the proposal of the Division were adopted by the Commission, and that WEXPRO could not conduct capital financing at all. The rationale of Mr. Sanders was that the proposals of the Division as to payment by WEXPRO to MOUNTAIN FUEL of $15 Million, the dedication of utility liquid hydrocarbons to underwrite future exploration, treatment of all gas liquids from the transferred properties as under the ownership of MOUNTAIN FUEL, and the requirement of WEXPRO to contribute one million acres of leasehold to the Joint Exploration Agreement, all would be regarded by the investment community as confiscation of Company properties to reduce natural gas rates, and as a regulatory invasion of the non-regulatory activities of MOUNTAIN FUEL. Such would directly result in significantly higher costs of capital to the utility functions of MOUNTAIN FUEL according to Mr. Sanders. The witness appeared before this Commission in 1973 during hearings in *P.S.C. Case No. 6668* to warn of the effect on the equity securities of MOUNTAIN FUEL if a proposal to merge the non-utility oil accounts with utility gas accounts for ratemaking purposes were adopted by the Commission.

74. The testimony is in conflict on the issue of whether MOUNTAIN FUEL's ability to conduct favorable and low cost capital financing will be adversely affected as a result of the existent Agreements or the Company's

alternate proposals. Mr. Norman for the Division took the position that because of the risks to MOUNTAIN FUEL, and the alleged subordination of MOUNTAIN FUEL creditors to the creditors of WEXPRO under the Agreements, the securities of MOUNTAIN FUEL would be less attractive, more risky, and thus will result in higher costs to the utility. Dr. Richard Pratt, Professor of Finance, University of Utah, testified to the contrary that the Agreements with WEXPRO or the alternate proposals would remove regulatory uncertainty with respect to non-utility oil operations of MOUNTAIN FUEL and would act as an incentive to the investor, thus strengthening, not weakening MOUNTAIN FUEL's position in the capital markets. The judgment of Dr. Pratt was that the MOUNTAIN FUEL-WEXPRO Agreement would result in favorable and lower cost capital financing for the utility.

Conclusion on Capital Financing

75. Upon consideration of all of the issues of the Case, we are convinced and find that the position taken by Dr. Pratt is the more persuasive and that the same be adopted insofar as it relates to the approval of the Joint Exploration Agreement and Purchase and Sale Agreement between the two companies. We also find that the ability of MOUNTAIN FUEL to finance on reasonable terms would be significantly and adversely impaired to the detriment of the public interest if the proposal of the Division were to be adopted.

USE OF GAS LIQUIDS IN UTILITY SERVICE

76. The Committee of Consumer Services differed from the position of the Division by claiming that natural gas liquids, primarily propanes, butanes and pentanes, extracted from the separator gas stream and sold by either

MOUNTAIN FUEL or WEXPRO under the Joint Exploration Agreement, could be used to enrich the natural gas supplied by MOUNTAIN FUEL to its Utah customers and should therefore be considered a utility product reserved to MOUNTAIN FUEL. Such position rested on the theory that the typical natural gas stream contains elements of propane and butane and that through air injection and other techniques, it is possible to utilize such liquids in MOUNTAIN FUEL's natural gas distribution system.

77. The testimony is uncontradicted in this Case that under standard practices in the oil and gas industry, only those natural gas liquids that can be feasibly and economically removed from the separator gas stream are, in fact, extracted. In other words, if separator gas contains, in addition to methane and ethane, heavy concentrates of propane, butane and pentanes, so as to justify a stripping plant, industry practice would typically provide for such. On the other hand, although such hydrocarbons may exist in a gas stream, if they cannot be removed economically with a reasonable return upon the investment obtained, the liquids will remain in the gas stream unless and until they drop out in traps or other devices in the pipeline system. The existence of inerts and the sour compound (H_2S) may also be determinative of the feasibility of stripping liquids from the separator gas stream.

78. In certain distribution systems and under emergency measures, propane-air mixtures are employed as a substitute for the typical natural gas stream delivered to utility customers. Dr. Bass testified that the injection of natural gas liquids into a distribution system was an expensive proposition and that while MOUNTAIN FUEL might possibly undertake a liquid injection method in its system, he could not determine whether it would be

economically feasible, since he had not had an occasion to undertake a study and analysis of MOUNTAIN FUEL's distribution system or its transmission pipelines to determine the economic and engineering feasibility of a gas-liquid injection method.

79. Clyde M. Heiner, Vice President of Engineering for MOUNTAIN FUEL, stated on Rebuttal that MOUNTAIN FUEL's gas distribution system is not relying and does not need to rely upon a propane-air injection method, that under present conditions, the pipline gas of MOUNTAIN FUEL even after removal of natural gas liquids, is a rich stream with content per standard cubic foot in excess of 1050 BTU's. Testimony was further adduced that the propane-air injection method was several times as expensive as MOUNTAIN FUEL's present system and that the position of the Committee to utilize such in the pipeline flow of MOUNTAIN FUEL would be both uneconomical and impractical. Mr. Heiner stated that additional heavier hydrocarbons such as propane, butanes and pentanes, would make the gas stream on MOUNTAIN FUEL's system "too hot" for the burners of utility customers and thus dangerous even if an adjustment were made to burner settings.

80. The witness Reid, who is one of the nation's leading specialists in hydrocarbon and gas treatment, testified on Rebuttal that not only was the removal of natural gas liquids from an otherwise adequate natural gas stream an appropriate industry practice, but failure to remove such liquids or the subsequent reinjection of them into a system such as that designed by MOUNTAIN FUEL would be extremely hazardous to Company personnel, to utility customers, and damaging to transmission and distribution facilities. In addition, the witness further

stated that reinjection of natural gas liquids into the gas stream, even assuming arguendo, it were necessary to boost the BTU level of the gas, would be a very expensive proposition costing many times the amount MOUNTAIN FUEL pays for field and pipeline gas, much less for its own production.

Conclusion of Use of Gas Liquids in Utility Service

81. Based on the evidence in the record, the Commission finds that the removal of economically recoverable natural gas liquids from the separator natural gas stream by MOUNTAIN FUEL and WEXPRO under the Joint Exploration Agreement is in accordance with sound industry practice and is reasonable. We further find that reinjection of such liquid hydrocarbons into MOUNTAIN FUEL's distribution system would be uneconomical, impractical and contrary to the public interest. Accordingly, natural gas liquids which are economically and feasibly removed from the separator gas, are not, per se, utility products which must be reserved under the Joint Exploration Agreement for the utility functions of MOUNTAIN FUEL. In fact this Commission has no jurisdiction to regulate the price of propane and butane such being the province of the Federal Energy Regulatory Commission.

PROPOSAL THAT TRANSFER OF PROPERTIES BE PREMISED UPON MARKET RATHER THAN BOOK VALUE

82. The Committee of Consumer Services urged the Commission that the transfer of the non-utility oil properties from MOUNTAIN FUEL to WEXPRO was unfair and inequitable because the consideration therefor was not premised upon the market value of the assets. It

was contended that this Commission should require an accounting of the transfer based upon market value of the transferred properties. The claim was made that gross revenues from the transferred properties for the calendar year 1976 approximated $39 million dollars, whereas, the depreciated book value of said assets alone was $33.1 million dollars. MOUNTAIN FUEL had not undertaken an actual or specific appraisal of the transferred properties to determine their fair market value, but Mr. Sanders, financial counsultant for MOUNTAIN FUEL, indicated that, as a rough observation, the fair market value of the properties would be in the area of $150 million dollars. According to the Committee, the disparity between the rough estimate of market value and the depreciated book value required a finding that the purchase and sale agreement between MOUNTAIN FUEL and WEXPRO was unfair and against the public interest. The other Protestants also made an issue of the market value of the assets transferred but their arguments focused on the magnitude of the transfer and their objective was to urge close scrutinization by the Commission of all aspects of the transfer rather than invalidation of it on this basis alone.

83. Under the Uniform System of Accounts which this Commission has long required MOUNTAIN FUEL to utilize, assets whether utility or non-utility are necessarily recorded at depreciated book value. It would be improper under such system for MOUNTAIN FUEL to attempt to write-up the value of its assets to their fair market value. The non-utility assets were transferred to WEXPRO in return for all of the outstanding common stock of that company at par value. The owners of the assets prior to their transfer, MOUNTAIN FUEL shareholders, continued to own the assets after their transfer because all of the

WEXPRO stock remained a MOUNTAIN FUEL asset. The testimony of all of the expert financial witnesses was in agreement that in any subsequent sale of WEXPRO stock, either by MOUNTAIN FUEL or through the offering of additional shares by WEXPRO, the capital markets would pay a price for said stock consistent with the market value of the WEXPRO assets. Thus, MOUNTAIN FUEL's interest in WEXPRO although it might be decreased in percentage ownership by a future equity sale, would not be at all diluted with respect to the value of the interest retained in the WEXPRO assets. As Dr. Pratt stated, capital financing by WEXPRO would only be undertaken if management anticipated being able to employ capital funds acquired in a manner to increase the assets and earnings of the company. Therefore, although MOUNTAIN FUEL's share of the pie might decrease, such decrease in percentage ownership would be more than offset by the increase in the size of the pie. Finally, through both testimony and argument, it was pointed out that the tax consequences of a transfer of assets from MOUNTAIN FUEL to WEXPRO at other than book value would be prohibitive.

Conclusion on Transfer at Book Value.

84. Based upon the evidence, the Commission finds that there is no basis in fact or law for claiming that the transfer of non-utility assets from MOUNTAIN FUEL to WEXPRO at depreciated book value was unfair, inequitable or contrary to the public interest. Such method of transfer is a normal and accepted method in dealings between a parent and its wholly owned subsidiary. Furthermore, it appears that any transfer at market value would have been prohibited by the tax

consequences resulting therefrom. We find no evidence on the record to support a belief that MOUNTAIN FUEL or its utility customers will be in any way damaged as a result of said transfer at depreciated book value.

DEFINITION OF GAS AND OIL

85. One of the announced purposes of this Case on Rehearing was to formulate a definition for gas and oil which could be, in the public interest, adopted to govern the future relationship between MOUNTAIN FUEI (sic) and WEXPRO under the Joint Exploration Agreement. The Commission received extended testimony and argument relative to the terms that would constitute an appropriate definition of gas and oil hydrocarbons. While the terminology to be employed is of material consequence, the uncontested evidence in the Case is that the definitions may be germane in but a relatively few number of circumstances. In the vast majority of discovery wells, the value of production is so dominant in favor of either gas or oil that the technical definition does not come into play. During the past ten years, MOUNTAIN FUEL has completed 163 productive wells, of which only 22 produced both oil and gas in commercial quantities. Of the 22 wells themselves, only one well was within a range of 30% to 70% gas to oil or oil to gas by the value of production. All of the other wells of MOUNTAIN FUEL during said ten-year period brought into production have been clearly either gas or oil under MOUNTAIN FUEL's classification system. With the scope of the problem at hand, we turn to those circumstances in which the discovery well produces both gas and oil in paying quantities.

General Discussion.

86. Hydrocarbons involved in gas and oil production, consist of compounds made up of variable numbers of hydrogen and carbon atoms. The basic hydrocarbon atom is methane with chemical formula of CH_4. The well known hydrocarbons in ascending order are: Ethane, C_2H_6, Propane, C_3H_8, Butane, C_4H_{10}, Pentane, C_5H_{12}, Octane, C_8H_{18}. Other heavier hydrocarbons such as Hexadecane, $C_{16}H_{34}$ and Asphaltene, $C_{80}H_{162}$, are found at higher places along the spectrum from methane to extremely heavier hydrocarbons.

87. There are no strict demarcation lines between various hydrocarbon products, one from the other, as to the form of production they may take. Natural gas, which primarily consists of methane, typically contains traces of ethanes and propanes and sometimes even butanes and pentanes, while motor fuel, normally considered to be oil, may typically contain traces of butanes, pentanes and heavier hydrocarbons. Depending upon the fluctuating character of production from each well, it may or may not be and often is not economical, to separate hydrocarbon mixtures of methane, ethane, propane, butane, pentane, hexane and other into their fundamental hydrocarbon compounds. The result is reliant on the particular and individual circumstances of each well, formation or field, and no hard and fast rule may be drawn for meaningful application under every set of facts. The testimony in this Case is not at variance on this score. Accordingly, the Commission does not find it to be of assistance or in the public interest to attempt to write-out a definition of hydrocarbon products on the basis of precise

or fundamental hydrocarbon compounds, because of their common mixture in the typical effluent that flows from the well during production.

88. The variety of compounds in the family of hydrocarbons will exist as gases or liquids, dependent upon temperature and pressure in the reservoir. For example, methane exists as a liquid at -260°F but is clearly in a gaseous state in a normal atmospheric pressure and temperature. Butane is a liquid at temperatures below freezing at standard pressure and at standard temperatures under moderate amounts of pressure but is in a gaseous state at standard temperature and pressure. A hydrocarbon or mixture of hydrocarbons may exist in a gaseous state in a reservoir at a high temperature and pressure, but may take the form of a liquid when standard production methods are employed to raise it to the surface. Due to the change in pressure and temperature, the form of the product will change. As an example, the reservoir fluid in the Weber Formation at the Brady Unit is a retrograde liquid much like the contents of an aerosol can. As the fluid comes up the pipe to the surface, it undergoes partial liquefaction to the point that on the surface, after passing through a field separator, it is principally in the liquid state. Accepted industry and required conservation regulations dictate that the Brady-Weber be developed as it is presently so that maximum hydrocarbon production can be accomplished. Because of the transitional character from the reservoir to the drill stem, to the wellhead, to the surface separator, the Commission finds that it is not of assistance or in the public interest to attempt a definition of hydrocarbon products as gas or oil strictly on the basis of whether they exist in a gaseous or liquid state in the reservoir or at the surface.

89. If a reservoir contains a range of hydrocarbon compounds pointing toward either gas or oil, the well will typically have attached a surface separator through which the effluent will pass. A separator is an engineering device which segregates the primary liquids from the primary gases with the liquids coming out of the bottom of the separator (referred to as either "separator liquid" or "stock tank liquid") and the gases coming out of the top of the separator (referred to as "separator gas"). Typically, separator gas must be treated for such factors as dehydration and removal of contaminants such as hydrogen sulfide (H_2S) and inerts such as carbon dioxide (CO_2). If the separator gas is rich in heavier hydrocarbons, such as propane, butane, pentane, natural gasoline and hexane, such hydrocarbons as can be economically recovered through condensation or treatment will normally be removed to avoid the production of "hot" gas which is too high in BTU content as well as to prevent potential condensation in the transmission or distribution system to the detriment of utility customers, Company personnel and equipment facilities.

90. The hydrocarbons removed from the separator gas are commonly referred to as natural gas liquids. Such liquids, along with the separator or stock tank liquids are sold by the barrel in transactions and at a price which are without the regulation of this Commission. On the other hand, natural gas which has been treated, cleaned, and purified is placed into a transmission system of MOUNTAIN FUEL for ultimate distribution to utility customers subject to the jurisdiction of this Commission. We find that the foregoing analysis is, after all is said, the thrust and import of the testimony of all of the knowledgeable and qualified witnesses to appear in this

Case. It is to say that the final product of exploration and development, after application of standard practices in the industry and predicated upon the specific conditions of each discovery well or formation, will decide the destiny of well classifications. Accordingly, the Commission finds that the end use of the hydrocarbon product as it is produced in a particular formation through a discovery well is the most helpful method upon which to base a definition of gas and oil under the evidence of this Case and that it is in the public interest to so do.

MOUNTAIN FUEL's Definition of Gas and Oil.

91. The Company's meaning of the terms gas and oil are set out in the alternate Agreements, MFS Exs. 4 and 5, paragraph 3 as follows:

> a. *Gas.* Gas is defined as marketable natural gas, which is raw gas from which certain hydrocarbon and non-hydrocarbon compounds have been removed or partially removed by processing.
>
> b. *Oil.* Oil is defined as liquid hydrocarbons, which are a mixture of hydrocarbons that either exist in the liquid phase in natural underground reservoirs and remain liquid at atmospheric pressure after passing through surface separating facilities, or which are separated from the natural gas as liquids either in the reservoir or at the surface through the process of retrograde condensation, normal condensation, absorption, adsorption, or other methods in field separators, scrubbers, gas processing plants, or cycling plants.

MFS Exs. 4 and 5 represent the first time in which the Company has reduced to writing a formal definition of the terms.

92. The essence of the definitions under the MOUNTAIN FUEL alternate Agreements is that gas is characterized as that hydrocarbon product which, under

normal industry standards, is capable, after removal of contaminants, of being introduced into a natural gas transmission system and sold as distributor natural gas, whereas oil is classified as all other hydrocarbon products which are, under industry standards, normally introduced into a barrel or tank and sold in the market in such form. Such definitions have been employed by MOUNTAIN FUEL over the years in its gas and exploration program to separate regulated utility products from non-regulated non-utility products. Under the definition, all stock tank liquids and natural gas liquids extracted after the separator facility are designated as oil and all separator gas, after extraction of any economically removable natural gas liquids, is designated as gas. The MOUNTAIN FUEL definition is predicated upon the end use of the products and is not dependent upon the changeable or transitory nature of the effluent from its original state in the reservoir through the field separator.

Proposed Definition of Division.

93. The Division did not submit in evidence a definition of gas or oil, since its position, under the testimony of Mr. Lambert, was that all hydrocarbons under the Joint Exploration Agreement, regardless of character, be split 50-50 between MOUNTAIN FUEL and WEXPRO. The closest that the Division came to a definition was set out in a secondary suggestion of Dr. Bass and contained in Division Ex. 17, p. 3, Para. A. Dr. Bass stated that while such was not a specific definition of gas and oil, for purpose of ownership under his substitute proposal, MOUNTAIN FUEL would "own and take possession of all gas from all separators in the separator-storage system" and WEXPRO would "own and take possession of all liquids (hydrocarbons and water) in the storage tank or

which may be discharged from a LACT unit''. Dr. Bass further testified, however, that in the allocation of operating costs, ''drip'' or condensate liquid produced from separator gas purchased for field use or flared or vented would be the property of each of the parties in the relationship to the ratio of separator gas and stock tank liquid reserves. Division Ex. 17 pp. 6-7, Para. C. D. While as we have noted, Dr. Bass did not attempt a precise or technical definition of gas and oil, to the extent that the ownership section of his substitute proposal might be considered as such, the concept of the end use of the product is followed except as to the gas liquids which are economically recoverable from the separator gas. Whereas the latter gas liquids have historically been treated by MOUNTAIN FUEL as a credit to either the utility gas accounts or the non-utility oil accounts of the Company depending upon the greater value of production and capitalization of the well, the suggestion of Dr. Bass would have all natural gas liquids credited to MOUNTAIN FUEL and no part thereof credited to WEXPRO.

Definition Proposals of Committee of Consumer Services

94. At the request of the Committee of Consumer Services, the Commission took administrative and judicial notice of the Oil and Gas Conservation Statutes of Utah, Wyoming and Colorado and to the definitions therein contained of oil and gas. 40-6-4(b) and (c) U.C.A. 1953, as amended; 30-216(g) Wyo. Statutes (1967 Repl. Vol.); 34-64-103(5) Colo. Rev. Stat. (1973). Such Statutes generally define oil as crude petroleum hydrocarbon products produced at the well in liquid form by ordinary production methods and which are not the result of condensation of gas after leaving the reservoir. Gas is

generally referred to as hydrocarbons mutually exclusive of oil. It was the argument of the Committee that the Utah Statute 40-6-4, Utah Code Annotated, 1953, constituted a legislative definition of oil and gas and was binding on MOUNTAIN FUEL in the well classification of oil and gas under the Purchase and Sale Agreement and the Joint Exploration Agreement. The statutory terms are markedly different than the historic definition employed by MOUNTAIN FUEL in determining gas and oil wells as well as being dissimilar to the definitional paragraphs in the alternate Agreements, M.F.S. Exhibits 4 and 5, between MOUNTAIN FUEL and WEXPRO.

95. MOUNTAIN FUEL called Cleon Feight, Director of the Division of Oil, Gas and Mining of the State of Utah. Mr. Feight, a lawyer by training and long associated with the oil and gas industry in Utah, testified that the definitions of oil and gas under the Utah Statutes set out above were for conservation and well spacing purposes to prevent the waste of natural resources and to protect correlative property rights. Mr. Feight further stated that propane and butane gas liquids are classified with oil in reports submitted to the Board of Oil and Gas Conservation of the State of Utah.

96. Based on the record of these Proceedings, the Commission finds that the definition of oil and gas as set forth in the Conservation Statutes of Utah, Wyoming, and Colorado, of which this Commission has taken notice, are for a different legislative purpose than the definition with which we are concerned in this Case, that they are not ordinarily employed in the oil and gas industry to define the production of hydrocarbons, and that they are not helpful in arriving at the terminology of oil and gas to be incorporated into the Agreements between MOUNTAIN

FUEL and WEXPRO in this Case. No other Protestant in the Case argued the relevancy of the oil and gas conservation Statutes.

97. The Committee further requested that the Commission administratively and judicially notice an alleged definition of gas and oil contained in H.B. 8444, Sec, 4988, a proposed 1977 Federal energy measure now before the United States House of Representatives. The Bill has not been adopted by the Congress, much less enacted into law. The particular Section 4988 relates to particular hydrocarbons subject to Federal taxation to encourage conservation and does not contain a description of natural gas. We find that Section 4988 of H.B. 8444 of the 1977 Congress is, for a number of reasons, unpersuasive in the determination of oil and gas definitions which, in the public interest, should be made applicable to the Agreements between MOUNTAIN FUEL and WEXPRO.

Conclusion as to Definitions

98. Under MOUNTAIN FUEL's historic exploration and development program as well as the present Joint Exploration Agreement, if a well were determined to be a gas well based upon the value of production, all associated liquid hydrocarbons (stock tank liquids and separator gas liquids) produced therewith were sold at the market price and credited as income to the utility accounts of MOUNTAIN FUEL. Conversely, if a well were determined to be oil, the historic practice and the present Joint Exploration Agreement requires that all liquid hydrocarbons (stock tank liquids and natural gas liquids extracted at the separator), be sold at the market price and credited as income to the non-utility oil accounts or, after January 1, 1977 to WEXPRO.

99. As is set forth more specifically hereafter in these Findings and Conclusions, the Commission has determined that the alternate proposal of MOUNTAIN FUEL, the concept of which is set out in MFS Exs. 4 and 5, is the more equitable and fair arrangement to MOUNTAIN FUEL in its joint exploration with WEXPRO. Under said Exhibits, all liquid hydrocarbons (stock tank liquids and natural gas liquids) after separation of a well that produced both gas and oil compounds, would be credited to WEXPRO with no income from the sale of natural gas liquids going to MOUNTAIN FUEL. However, we find that under all the evidence, it is fair and equitable and in the public interest that there be an equal division of the income from natural gas liquids which are extracted from the gas stream after field separation between MOUNTAIN FUEL and WEXPRO and that the definitions of gas and oil, for purposes of the Purchase and Sale and Joint Exploration Agreements between the two Companies, should be modified accordingly. We, therefore, find that the following definitions of gas, oil and natural gas liquids to be employed in the Purchase and Sale Agreement and Joint Exploration Agreement between MOUNTAIN FUEL and WEXPRO, should be set forth in the following manner:

(1) *Gas.* Gas is defined as natural gas, which is or may be made marketable into a natural gas pipeline and from which certain hydrocarbons and non-hydrocarbons may be or have been previously removed or partially removed by processing.

(2) *Oil.* Oil is defined as liquid hydrocarbons which are a mixture of hydrocarbons that remain liquid at the wellhead or after passing through a surface separating facility, if such is used.

(3) *Natural Gas Liquids.* Natural gas liquids is defined as hydrocarbons separated from a natural

gas stream after primary or initial separation by natural condensation or further processing.

PROVISIONS TO BE INSERTED IN THE AGREEMENT OF PURCHASE AND SALE AND THE JOINT EXPLORATION AGREEMENT

100. It has been our intent in these Findings and Conclusions to review and pass on every significant issue of fact and law, not heretofore resolved, in this Proceeding. As we have stated, the evidence has been extensive and detailed in which technical, engineering and economic concepts have been considered at length under almost microscopic examination and the length of these Findings and Conclusions is matched only by the complexity of the legal and factual issues framed and presented to the Commission as well as the extended character of the Proceedings.

101. The matter ultimately comes down to a consideration of those provisions for insertion in the Agreements between MOUNTAIN FUEL and WEXPRO which under all the evidence, we find and conclude to be most compatible with the public interest. As this Commission has stated on numerous occasions, the public interest equation consists of a balancing of all of the interests, ratepayer, shareholder, and the Company with the firm objective of securing reliable and efficient utility service at reasonable and just rates, of maintaining strong natural gas reserves for the benefit of present and future utility customers, to protect the utility customer from exorbitant natural gas charges, and to maintain the financial integrity of the Company.

102. We believe it not to be the responsibility of this Commission to make or write contracts for a utility, or to

draft or approve every single clause of any agreement, or to sit in final judgment as to the policy and purpose behind contractual arrangements between a public utility and a third party. That is a function which we believe rests primarily with utility management. As the Supreme Court of California declared in *Pacific Telephone & Telegraph Co. v. Public Utility Commission, 215* P.2d 441 (Cal. 1950):

> "Almost every contract a utility makes is bound to affect its rates and services. Moreover, the question whether a contract or practice is reasonable is one on which, except in clear cases, there is bound to be conflicting evidence and considerable leeway for conflicting opinions. *The determination of what is reasonable in conducting the business of the utility is the primary responsibility of management.* If the commission is empowered to prescribe the terms of contracts and the practices of utilities and thus substitute its judgment as to what is reasonable for that of the management, it is empowered to undertake the management of all utilities subject to its jurisdiction. It has been repeatedly held, however, that the commission does not have such power." (Emphasis Added) (215 P.2d 445)

Once management performs its function, however, it is the duly (sic) of this Commission by law to review and approve or disapprove contracts involving the utility functions of a company in which there is presented essential questions of the public interest. We have not retreated from that calling in this Case and do not intend to do so.

103. In consideration of all the evidence introduced, the cross-examination conducted and the arguments submitted, we find and conclude that on balance, the

basic elements of the alternate proposal of MOUNTAIN FUEL as set out in MFS Exs. 4 and 5 are the most fair and equitable to the utility customer and are most consonant with the public interest. Such joint exploration arrangement sends all natural gas to MOUNTAIN FUEL at the cost of service and all liquid hydrocarbons to WEXPRO at the cost of service, with the exception of natural gas liquids from the separator gas and as to which we find there should be an even division of the resulting income between the two Companies. Such proposal is to the greater benefit of the utility customer because it:

> (1) is more likely to insure and encourage a strong exploration program on the part of MOUNTAIN FUEL resulting in new dedications of natural gas to the Company's system for present and future use, all at a time when this country is faced with a severe natural gas shortage; and
>
> (2) will bring such new dedications of natural gas to MOUNTAIN FUEL's system in Utah at the cost of service as contrasted to the regulated field or pipeline price. The whole history of MOUNTAIN FUEL is that cost of service gas has been at a lower price and has been of significant benefit to the utility customer.

104. We find that the test which this Commission has previously used to determine the fairness, reasonableness, and justice of the exploration and development activities of MOUNTAIN FUEL is still the strongest indicator of a successful exploration and development program. It is our determination that the Agreement of Purchase and Sale and Joint Exploration Agreement between MOUNTAIN FUEL and WEXPRO should have incorporated therein the following elements:

(1) *Joint Exploration Agreement.*

(i) With respect to joint exploration acreage, all expenses up to $6,240,258 including lease maintenance, delay rentals, disposition, geological, geophysical, personnel, non-productive dry hole drilling, and other incidental expenses shall be shared by MOUNTAIN FUEL and WEXPRO equally. (Tr. 2909);

(ii) A definition section should be inserted in the contract in accordance with said terms as set out in Paragraph 99 of this Report and Order. (Tr. 2912);

(iii) If a gas well is discovered, MOUNTAIN FUEL pays for and capitalizes 100% of the cost in its utility account (plant in service). All gas produced from said well will be owned by MOUNTAIN FUEL and come to it at cost. All oil from said well will be owned by WEXPRO to be obtained at the cost of service of production. Acreage logically related to the well shall be capitalized in the MOUNTAIN FUEL utility account (plant in service) but retained in the Joint Exploration Agreement. All income, costs and expenses associated with the extraction of natural gas liquids from the gas stream by natural condensation or further processing after field separation shall be divided evenly between MOUNTAIN FUEL and WEXPRO 50-50 in accordance with the definition Paragraph, which is to say liquid hydrocarbons extracted or furthermore, those liquids derived after separation and not the liquids taken during separation.

(iv) If an oil well is discovered, Wexpro pays 100% of all costs associated with the well and the well is capitalized in WEXPRO's accounts. MOUNTAIN FUEL shall own all gas produced from the well and shall pay WEXPRO the cost of

service price for the production of such gas. The acreage logically related to the well shall be transferred to WEXPRO and capitalized in WEXPRO's accounts. All income, costs and expenses associated with the extraction of natural gas liquids from the gas stream by natural condensation or further processing after field separation shall be shared between MOUNTAIN FUEL and WEXPRO on a 50-50 basis in accordance with the definition Paragraph, which is to say liquid hydrocarbons extracted or furthermore, those liquids derived after separation and not the liquids taken during separation.

(v) If a development gas well drilled on acreage held by MOUNTAIN FUEL results in a dry hole, all expenses of such well will be shared equally between MOUNTAIN FUEL and WEXPRO. If a development oil well is drilled on acreage transferred to WEXPRO under the Joint Exploration Agreement and results in a dry hole, WEXPRO shall pay 100% of the cost of such well. (Tr. 2910);

(vi) The determination of whether a well is a gas well or an oil well will be based upon the value of production of each commodity from the well for a 30-day test period. (Tr. 2910);

(vii) All acreage under the Joint Exploration Agreement shall be held by MOUNTAIN FUEL. Oil producing acreage shall be held by WEXPRO. WEXPRO should pay 50% of all drilling expenses on acreage under the JEA even is such is gas producing acreage held in the utility plant in service account. If a well is successfully completed on such acreage it will be classified as either a gas or an oil well in accordance with the terms set out above. MOUNTAIN FUEL shall pay no drilling expenses on any WEXPRO held acreage. (Tr. 2909-2910);

(viii) *With respect to "farm-out" arrangements (as generally defined in Paragraphs 61-65 herein) under the Joint Exploration*

Agreement MOUNTAIN FUEL may enter into such agreements with a third party or with WEXPRO, if it is deemed advantageous to the Company or it may avoid contributing to joint drilling costs by farming out its representative interest in joint exploration acreage to a third party or to WEXPRO. With respect to any such farm-out of MOUNTAIN FUEL's interest in joint exploration acreage, the express terms of the farm-out arrangement, specifically those hereafter set out, shall be set forth in a written farm-out agreement so as to be clearly understood. Moreover, no conditions or terms of any farm-out arrangement entered into between MOUNTAIN FUEL and a third party or WEXPRO shall contain provisions which deprive MOUNTAIN FUEL of the natural gas reserves developed on the retained acreage under any such farm-out. In addition, the terms of any farm-out agreement shall contain the following provisions relative to the retained interest of MOUNTAIN FUEL: (a) If MOUNTAIN FUEL farms out its interests and a gas well is discovered, then after payout MOUNTAIN FUEL shall own all gas from the retained acreage which shall come to MOUNTAIN FUEL at cost. Incidental oil from the retained share of a gas well on farm-out acreage shall be owned by WEXPRO and WEXPRO shall pay MOUNTAIN FUEL the cost of service for such oil. MOUNTAIN FUEL's retained share of such well and acreage shall be capitalized in the utility accounts of the Company; *(b)* If an oil well is discovered on acreage farmed out by MOUNTAIN FUEL, the retained interest in such well and acreage shall be transferred to WEXPRO to the extent of interest earned after payout. The retained interest of incidental gas from such well shall be owned by MOUNTAIN FUEL for which MOUNTAIN FUEL shall pay WEXPRO the cost of service. The income, costs and expenses associated with the extraction of natural gas liquids from the gas stream by natural condensation or further processing after field separation from wells completed

under farm-out agreements shall be shared 50-50 between MOUNTAIN FUEL and WEXPRO to the extent of the retained interest. MOUNTAIN FUEL and WEXPRO may jointly agree to farm out joint exploration acreage to a third party. However, WEXPRO shall be prohibited from farming out its interest in joint exploration acreage in order to avoid its contribution to drilling costs. Acreage retained from a farm-out will remain with MOUNTAIN FUEL if a gas well is discovered and transferred to WEXPRO if an oil well is discovered. (Tr. 2911-2912);

(ix) The cost of service formula set out in Exhibit MFS-5 at page 3, paragraph 3 shall be included in the Joint Exploration Agreement. (Tr. 2912).

(2) *Agreement of Purchase and Sale.*

(i) The non-utility oil properties and interest of MOUNTAIN FUEL as they existed on December 31, 1976, are transferred to WEXPRO in consideration for the issuance to MOUNTAIN FUEL of WEXPRO common stock as set forth in the evidence. (Tr. 2912);

(ii) Gas in the Brady-Weber formation will be reserved to and owned by MOUNTAIN FUEL at blowdown. At that time, MOUNTAIN FUEL will reimburse WEXPRO for the depreciated book value of wells utilized by MOUNTAIN FUEL to thereafter produce the gas. Further, all gas reserves currently developed by utility wells at the Brady, Spearhead Ranch, Dry Piney, and Birch Creek Fields are reserved to and owned by MOUNTAIN FUEL, except for ordinary lease use under sound management and engineering field practices. (Tr. 2912, 2913);

(iii) MOUNTAIN FUEL shall receive all natural gas from production which is currently available to its system from the transferred

properties at the cost of service and MOUNTAIN FUEL wil be the owner of said gas. (Tr. 2913);

(iv) The income, costs and expenses associated with the extraction of natural gas liquids from the gas stream by natural condensation or further processing after field separation, will be shared by MOUNTAIN FUEL and WEXPRO evenly, on a 50-50 basis. (Tr. 2909, 2913-2915);

(v) MOUNTAIN FUEL will own all gas produced and sold from the transferred properties after January 1, 1977. Gas required for pressure maintenance for field operations will be returned to MOUNTAIN FUEL at the cost of service. (Tr. 2913);

(vi) In all aspects of exploration and production in field operations, both MOUNTAIN FUEL and WEXPRO should be required, by contract, to exercise standard and accepted management and engineering practices. (Tr. 2913);

(vii) As to properties acquired by WEXPRO other than the transferred acreage and that which comes to it under the Joint Exploration Agreement, MOUNTAIN FUEL shall have a right of first refusal to purchase at the market price, all natural gas discoveries on said other properties in the States of Montana, Idaho, Wyoming, Colorado, Utah, New Mexico, Arizona, and Nevada, said right of first refusal to expire on January 1, 1987. The contract shall provide that MOUNTAIN FUEL shall have a further option to renew such right of first refusal for an additional ten-year period on the same terms. (Tr. 2913);

(viii) In connection with the production and sale of gas and gas liquids there shall be inserted in the Agreement a definition of oil and gas has (sic) hereinabove defined in Paragraph 99 of this Report and Order. (Tr. 2912);

(ix) There should be inserted in the Agreement the cost of service formula consistent with that set out in Paragraph 3 of MOUNTAIN FUEL's Exhibit MFS-4, p. 3. (Tr. 2913);

(x) The contract should provide that WEXPRO will cooperate with MOUNTAIN FUEL in preparing and filing with this Commission on the first day of June, 1978 and the first day of June each and every year thereafter an annual report and accounting for the preceding calendar year, of exploration and development activities, including expenses, capital costs, and revenues associated therewith on properties under or affected by the Purchase and Sale Agreement and Joint Exploration Agreement. (Tr. 2913).

105. Based upon testimony of the President of MOUNTAIN FUEL and the stipulation of counsel for MOUNTAIN FUEL and WEXPRO, the Commission finds and concludes that simultaneously with the execution of an amendatory Purchase and Sale Agreement between MOUNTAIN FUEL and WEXPRO, as set forth in Finding 104 herein, WEXPRO should transfer or retransfer over to MOUNTAIN FUEL by appropriate documents of conveyance certain gas producing properties located on the west slope of the Rocky Mountains in Colorado, generically described in the Hearings as the "West Slope properties". Said properties include those wells and leases in the Big Horse Draw, Dragon Trail, Egmar, Lower Horse Draw, West Douglas Creek, Black Butte and Tierney Fields. Said properties are to be reserved to and owned by MOUNTAIN FUEL as part of the basic elements of the alternate proposal of MOUNTAIN FUEL accepted by the Commission. See Finding 103.

MOTIONS AND OTHER MATTERS

106. The Motion of the Committee of Consumer

Services for an accounting of the expenses of exploration in the rates paid by MOUNTAIN FUEL from its utility accounts and for repayment of the same by the shareholders of MOUNTAIN FUEL, has been made heretofore and denied in P.S.C. Case No. 77-057-03, and said Motion should be and the same is again denied as without legal foundation.

107. The Motion of the Division for discovery of confidential maps, materials, and trade secrets of MOUNTAIN FUEL has been urged on several occasions throughout the Proceedings. The Motion is not timely, is irrelevant and the same is hereby denied once again.

108. The Motion of all the Protestants for a further Rehearing on the issues of jurisdiction and classification filed on the 20th day of September, 1977 should be and the same is hereby denied. The reasons are several. First, the Motion is out of time and not in accordance with the Statute 54-7-15, U.C.A. 1953. Second, the Division indicated that substantially all of the evidence which it intended to produce on the issue of classification and jurisdiction was, in fact, presented to the Commission in these Proceedings. From the evidence in the record, there has been nothing introduced nor argument made that would justify a vacation of the July 20, 1977 and August 29, 1977 Orders of this Commission with respect to jurisdiction and classification.

ORDER

WHEREFORE, having found specially the facts in the matter and the conclusions of law appurtenant thereto and the same having been entered, it is now ORDERED that:

I. Within 20 days from the entry of this Order, MOUNTAIN FUEL shall notify this Commission in writing as to whether the terms of this Order, specifically Paragraphs 99 and 104, have been approved and ratified by the Board of Directors of MOUNTAIN FUEL;

II. Within 20 days from the entry of this Order, WEXPRO shall notify this Commission in writing as to whether the terms of this Order, specifically Paragraphs 99 and 104, have been approved and ratified by the Board of Directors of WEXPRO;

III. If the terms of Paragraphs 99 and 104 of this Order are ratified and approved by the Boards of Directors of MOUNTAIN FUEL and WEXPRO respectively, MOUNTAIN FUEL shall file with this Commission, within ten days of the date of such ratification and approval, a form of Purchase and Sale Agreement and Joint Exploration Agreement to be executed by MOUNTAIN FUEL and WEXPRO;

IV. The Purchase and Sale Agreement between MOUNTAIN FUEL and WEXPRO, as modified by the provisions of Paragraphs 99 and 104 of the Findings and Conclusions herein, will be deemed approved and will be effective as of January 1, 1977.

V. The Joint Exploration Agreement between MOUNTAIN FUEL and WEXPRO, as modified by the provisions of Paragraphs 99 and 104 of the Findings and Conclusions herein, will be deemed approved and will be effective as of January 1, 1977.

DATED at Salt Lake City, Utah this 11th day of April 1978.

/s/ Milly O. Bernard, Chairman

(SEAL)

/s/ Olof E. Zundel, Commissioner

Attest:

/s/ Victor N. Gibb, Secretary

I dissent:

The Commission's Report and Order represents a fundamental abdication by the Commission of its statutory responsibility to protect the public interest. The result of this abdication, which allows the transfer to an unregulated company of well over $150 million worth of assets discovered and developed with funds provided by the ratepayers of this state, under prior order of this Commission, can only be characterized a regulatory outrage.

At the outset, I should like to briefly allude to the unreasonable time constraints imposed upon the dissenting Commissioner by the Majority of this Commission. The Proposed Report and Order submitted by counsel for Mountain Fuel Supply Company at the request of the Majority of the Commission, was filed with the Commission November 11, 1977. It was not until approximately one week ago that the Majority of the Commission advised this Commissioner of its final determination on what constituted "liquid hydrocarbons after separation," the issue which seemingly went unresolved in the mind of at least one of the

Commissioners since November of last year. Since I learned only last week of the other Commissioner's definition of "liquid hydrocarbons after separation," I have not had adequate time in which to carefully review the Majority's Report and Order in its final form, together with the underlying evidence or exhibits related thereto. I feel very strongly that if public interest justifies a five month delay in getting out the Commission's Order, it equally demands a reasonable time in which to respond on the important and significant issues involved in this case. Because of the insistence on the part of the Majority of this Commission to issue this Order today, I have been able only to address the most glaring and fundamental errors, and I recognize that there are many issues and problems with the Majority Order which will of necessity, go unanswered herein.

I.

The Commission has, in effect, allowed Mountain Fuel to exercise jurisdiction over itself in classifying properties as "non-utility" for its own benefit and the exclusive benefit of its shareholders. The Majority's decision to let stand the jurisdictional findings of July 20, 1977 and August 29, 1977 (Finding No. 108), is a fundamental error of law. The Commission has jurisdiction over Mountain Fuel's transfer of assets to Wexpro and has jurisdiction to approve, disapprove, or modify the Joint Exploration Agreement to ensure conformance to the public interest. The Majority has chosen to ignore Sections 54-4-4, 54-4-7, 54-4-26 and 54-4-1(30) of the Utah Code, which clearly confer jurisdiction in this matter. But, more disturbing than this legal error is the fact that the July 20 and August 29 orders on jurisdiction were entered without evidentiary hearing.

Finding No. 108 that "nothing introduced nor [any] arguments made . . . would justify a vacation of the . . . Orders . . . with respect to jurisdiction . . ." is inconceivable, and totally unsupportable. In fact, the Division convincingly demonstrated, through competent evidence, that the exploration and development of oil and gas by Mountain Fuel is a utility activity. It is uncontroverted that the Commission for over thirty years has placed the ratepayers of Mountain Fuel in the business of exploration and development for oil and gas — if that was non-utility activity, over $50 million in allowances should be refunded to the ratepayers. It is also uncontroverted that Mountain Fuel will continue to purchase substantial quantities of gas from Wexpro, and that Mountain Fuel and Wexpro will continue to explore for and develop oil and gas cooperatively. The Majority's findings on jurisdiction *(See* Finding Nos. 11 and 108) overlook this clear evidence. Either the Majority failed to reconsider their orders on jurisdiction, in which case I find serious due process problems, or it made an arbitrary, capricious, and unsupportable determination on this issue.

II.

I find the Majority's conclusion on the prior classification of non-utility assets without foundation and in error. The Majority virtually admits its own dereliction of duty in its conclusion that "the properties and acreage at Spearhead Rance — Fox and Brady were reasonably classified in a manner *consistent with Company practice.*" (Emphasis added.) Conclusion No. 45. It is *our* function, not the Company's, to determine the correctness of such classifications.

Moreover, the Majority does not even attempt to come to grips with the crucial issue here, *i.e.*, whether Mountain Fuel's classification method was valid, a question which must be answered in light of the transfer of non-utility properties to Wexpro. The Majority was willing to state only that "Mountain Fuel acted in good faith in classifying the acreage at Spearhead — Fox and Brady and . . . said properties were properly in the non-utility accounts as of January 1, 1977." No reasoned basis appears for this other than reliance on Mountain Fuel's "good faith" in the application of its own system. This clearly begs the question whether the system is acceptable. Whatever the reasons that the Commission apparently never undertook to examine the Mountain Fuel classification system prior to 1974, in Case No. 6668, its determination in that case was clear — the system was subject to serious doubt. No sophistry by Mountain Fuel can retroactively amend that fundamental determination. Yet wholly aside from the Commission's determination in Case No. 6668, the creation of Wexpro and the proposed transfer of so-called "non-utility" assets surely necessitate a careful scrutiny *de novo* of the system, for once the transfer is made, there will be no way to remedy any injustices which occur. The Majority's action ignores that need.

The Commission's finding on the classifications of Spearhead and Brady is unsupportable. It is uncontroverted that Spearhead and Brady were both transferred from the utility to the non-utility accounts upon the completion of only one well. These transfers were contrary to Mountain Fuel's own system of classification. The Majority thus goes one step further in the abandonment of its function. After letting Mountain Fuel dictate the propriety of the system it would use, it then allows Mountain Fuel to

modify the system to serve its own interests as applied to Spearhead and Bardy, and to possibly other fields. This is what I mean by "regulatory outrage,"

Finding No. 22, that "the great and preponderating testimony is that the classification system was extant, known generally, reviewed from time to time by the Commission as to particular fields or wells, and that on balance it was applied with reasonable consistency," is wholly unsupportable. The evidence, in particular the testimonies of Dr. Bass and Mr. Norman, suggested a number of different ways in which the classification system had been applied inconsistently and arbitrarily. The evidence is clear that the details of how the classification system was applied were known only to Mountain Fuel and apparently were never reviewed carefully by the Commission as to particular fields or wells. The classification system was never reduced to written form, either by Mountain Fuel or the Commission, permitting Mountain Fuel to apply the system in whatever fashion it desired.

III.

The Majority has ignored the most persuasive legal authorities presented in this matter by depriving the ratepayers of the benefits accruing from their payment of Company exploration and development expenses. It is uncontroverted that during the period from 1966 through 1976 ratepayers have been required to pay over $37 million in exploration and development expenses prior to the discovery of commercial wells. Non-utility accounts of Mountain Fuel during the same period, on the other hand, were only required to bear slightly over $8 million of such expenses. The burden on Mountain Fuel's ratepayers has left Mountain Fuel's stockholders in the enviable position

of merely having to capitalize commercial discoveries. The law presented to this Commission is clear that ratepayers cannot be deprived of the benefits from the risk they were ordered to assume. *Democratic Central Committee v. Washington Transit Comm.*, 485 F.2d 786 (D.C. Cir. 1973) *cert. denied,* 413 U.S. 935; *Re Wyoming Gas Co.*, 40 PUR 3d 509 (1961); *Re Michigan Consolidated Gas Co.*, 78 PUR 3d 321 (1969).

The Commission's reliance on *Board of Public Utility Commissioners v. New York Telephone Company,* 271 U.S. 23 (1955), (sic), for the purpose of the issues in this case is wholly misplaced. The Court in *Democratic Central Committee* noted that *New York Telephone* is inapplicable to the question before the Commission. Aside from the fact that *New York Telephone* was a pre-New Deal case, the viability of which is subject to question, the decision in that case does not support the Commission's order of today. *Democratic Central Committee* clearly sets forth the law: "In situations where consumers have shouldered these burdens on an asset which produces a gain, the equities clearly preponderate in their favor." 485 F.2d at 810. In other words, the right to gain follows risk of loss. "Those who bear the financial burden of particular utility activity should also reap the benefit resulting therefrom." 485 F.2d at 808.

The rationale of the *Democratic Central Committee* case is persuasive. Yet, the Majority does not even discuss this decision on the very issue before it. This omission demonstrates the inadequacy of merely signing an order drafted by Mountain Fuel.

The Commission's action today deprives the ratepayers of the benefits to which they are entitled. The value of the liquid reserves transferred from Mountain Fuel

to Wexpro exceed $150 million, according to Mountain Fuel's own witness, and the assets transferred earned over $25 million before taxes in 1976. Today's order does nothing to affect that transfer. The insignificant changes which the Commission orders to the Purchase and Sale Agreement and the Joint Exploration Agreement do virtually nothing to credit the ratepayers with an equitable share of the benefits to which they rightly are entitled.

I must specifically point to Finding No. 18 of today's order as an example of the Commission's disregard for the public interest. The Majority accepts without question the precise language submitted by counsel for Mountain Fuel that,

> the concept has long been accepted that as a corollary to the understanding that gas reserves would be developed by the Company and sold in its system at the lower cost of service, if exploration and development resulted in oil hydrocarbons and associated liquids, said discoveries would be unregulated and the owners of the Company would be entitled to sell such product and maintain the revenues therefrom at a competitive price in the field.

If the Commission had ever accepted that "concept" it would clearly have been acting contrary to law. But this finding is absolute nonsense. There is no evidence in the record to support it. Not only has such a "concept" never been enunciated by the Commission, but this finding is inconsistent with the Commission's own order in this matter. Notwithstanding the inadequacy of the Commission's division of liquid hydrocarbons, the fact remains that the Commission did require a division of "all liquid hydrocarbons after separation." This required division contradicts the above-quoted finding. The

Commission's failure to justify such a departure from its finding, without adequate support from the record, is arbitrary and in error.

IV.

In Finding No. 41, the Majority expressly overrules the January 14, 1974 Order in Case No. 6668. Yet, cited quotations on page 27 of this Order clearly indicate that the Commission never intended in the January 21 and July 18, 1974 Orders in Case No. 6668, to overrule the January 14 Order. It is not necessary in this case that the Commission do so; it need make no finding with regard to that issue. The attempt of Mountain Fuel to obtain a ruling in this case which it could not get in Case No. 6668 is not only an affront to the members of the former Commission, but should offend reasonable sensitivities of this Commission.

V.

The order of today even violates the Commission's oral ruling of October 28, 1977. The most fundamental contradiction of its own October 28 ruling involves the division of "natural gas liquids," in Finding Nos. 99, 104(ii), (iii), (iv), (viii), and 104 (2)(iv). The Commission's order ignores its earlier requirement that "the income from all liquid hydrocarbons after separation will be shared by MFS and Wexpro on a 50-50 basis." Chairman Bernard made it clear at the October 28 proceedings that this was to mean "all liquid hydrocarbons." (Tr. at 2914.) The Commission's order is now inconsistent with the earlier prouncement. (sic) By providing for a "division of the income from natural gas liquids which are extracted from the gas stream after field separation" and by defining natural gas liquids as "hydrocarbons separated from a

natural gas stream after primary or initial separation by natural condensation or further processing," the Commission's order eliminates most of the liquids which the Commission ordered that Mountain Fuel share. This is intolerable. If the Commission desired on October 28 to include only such liquids, it could easily have so stated. For some reason, the Majority has altered its position on that point, at the expense of the ratepayers.

CONCLUSION

In summary, I am greatly troubled by the Commission's acceptance, without any significant change or modification, of findings and conclusions which more nearly appear to be a treatise or exposition on gas and oil exploration and development, rather than sound legal findings and conclusions supported by competent evidence in the record. The Commission has permitted counsel for Mountain Fuel, without any restraint whatsoever, to put forth the regulatory policy and philosophy of this state, a result which I am sure was not intended by the legislature.

The overall impression I have gained from the record in this case is that the prior Commissions, except for the Commission in Case No. 6668, did not have a fundamental understanding of what Mountain Fuel has historically characterized as "oil". The order in this case makes it abundantly clear that the current Commission has the same fundamental problem. The order has failed to meet and adequately address the classification and definitional issues in this case. Without laying to rest once and for all the appropriate classification of hydrocarbon products and the proper definitions of "natural gas" and "oil", I fear that as technology changes or as the relative

prices of the various products change, that what might be "natural gas" today may well be something far different tomorrow. The failure of the Commission's order to clearly set forth definitions and a more appropriate classification scheme places the common management of Mountain Fuel and Wexpro in a position to maximize their profits to the benefit of shareholders, and at the expense of Mountain Fuel's customers and ratepayers.

Mountain Fuel's principal business activities over the years has been to distribute natural gas to its customers. It has sought and acquired lease-hold acreage principally in Utah, Wyoming, and Colorado for the purpose of natural gas exploration. That acreage has always been used or useful in its natural gas utility buiness. In the early years after the formation of Mountain Fuel, revenues from "oil" production were insignificant, and it appears that prior Commissions never critically reviewed the propriety of reporting such revenues as non-utility. I would conclude that the exploration acreage held by Mountain Fuel over the years was used or useful in its natural gas utility business, and should have always been classified as utility assets. The fact that revenues from "oil" or other liquid hydrocarbons have become very significant during the last few years does not change the basic character of those assets. However, it appears that the shareholders of Mountain Fuel have come to expect an unregulated return from oil properties, for which the risk capital was largely derived in rates charged its customers as ordered by the Commission. It appears to this Commissioner that because of a 1974 suspension of Mountain Fuel's stock on the New York Stock Exchange, and because of a shareholder proxy fight thereafter, this Commission is fearful of taking the necessary action required to put the public interest ahead

of the avarice of Mountain Fuel shareholders. The achieving of a reasonably fair and equitable economic balance between the competing interests of shareholders and customers has simply not occurred through the decision of the Majority of this Commission.

DATED at Salt Lake City, Utah this 11th day of April, 1978.

/s/ Kenneth Rigtrup, Commissioner

Before the Public Service Commission of Utah

In the Matter of the Petition of the Division of Public Utilities to consider the proposed transfer of certain wells, leases, lands, and related facilities and interests of MOUNTAIN FUEL SUPPLY COMPANY TO WEXPRO COMPANY.

Case No. 76-057-14
RESPONSE TO DISSENT
ADDENDUM TO ORDER

As the majority Commissioners in this case, we have now read the dissenting opinion which was issued without opportunity for prior review. While it is the privilege and even the duty of a member of this Commission to dissent from any decision reached by the majority with which he disagrees and to vigorously express the reasons therefor, the intemperate and abusive language of the dissent in this case is tantamount to an attack upon the integrity and veracity of this Commission, upon its adjudicatory processes, as well as upon the character of the individual Com-

missioners, themselves. It is to this aspect of the dissent that this supplemental Addendum is written.

The protection of the public interest has been of the uppermost consideration of the Commission in this Report and Order. The evidence in the case fairly reveals that the Report and Order will reasonably ensure and provide for a continued supply of low cost natural gas to customers in this State. The dissent, including that issued orally on October 28, 1977, would most probably have spelled an end to the utility exploration of Mountain Fuel, thus raising the specter of enormous and possible harmful consequences for natural gas users. It continues to be our view that the public interest prompts a balancing of all interests viewed in their historical and present setting for both ratepayers and stockholders to achieve a reasonable result in the case.

Secondly, the Report and Order does not, as alleged by the dissent, turn over to Mountain Fuel self-regulatory authority. The classification of properties and the classification system was exhaustively treated in the evidence on rehearing with all parties being given wide latitude to present testimony on the issue. In spite of that fact, the dissent states that not only were the findings on classification unsupported, but that no prior Commission had ever really understood and reviewed the classification system, except the 1974 Commission in Case No. 6668. The dissent underestimates the knowledge, experience, and wisdom of past Commissions who have sat for better than 30 years in one case after another and passed on the classification of various properties, recognized the distinction between utility and non-utility exploration and development accounts, established the reasonableness of the exploration expense, and weighed the relationship and

nature of capital costs and operating expenses paid by the Company for exploration and development. The argument is not only unsupported but presumptuous that the classification of gas and oil properties as utility and non-utility and the relationship of capital costs to operating expenses was only uncovered by enlightended (sic) minds for the first time barely two years before this case was commenced.

Thirdly, the dissent claims that the majority's findings and conclusions on jurisdiction and classification are a "dereliction of duty" and "regulatory outrage". The dissent does not point to a single case in which this Commission has ever concluded that non-utility oil properties were jurisdictional assets subject to regulation of this Commission or that the classification system of Mountain Fuel was erroneous and not in the public interest. On the other hand, the majority opinion cites a string of decisions of the Commission precisely holding that the oil accounts of the Company are non-jurisdictional and approving or disapproving the classification of properties under a system which, the conclusive evidence shows, was the same as that in effect on January 1, 1977. Accordingly, while the Report and Order is consistent with all the previous holdings of this Commission on the subject of jurisdiction and classification, the dissent constitutes a radical departure from past adjudications. The dissent would evolve a new doctrine of utility jurisdiction and then apply the doctrine retroactively to assets which have been acquired, held and accounted for years as non-utility property. If the precedent of the past measured alongside the thrust of the dissenting opinion constitutes "regulatory outrage" and "dereliction of duty", such indictment must be laid at the feet of every Commission for the past 30 years.

Fourthly, the dissent states that the issue of jurisdiction was decided without evidentiary hearings. This case was commenced and the initial hearings held prior to the dissenting Commissioner being seated. The jurisdictional issue was explored by the Commission at the initial public hearing on December 29, 1976, with Division counsel being present. The Division argued at that time that if the transferred properties were non-utility, the Commission would have no jurisdiction over such transfer. While the dissenting Commissioner took his seat and different Division counsel were added thereafter with new arguments made during the course of the proceedings, the fundamental framework and soundness of the initial hearing did not change. Moreover, the Division stipulated an evidentiary fact on July 1, 1977, that the properties transferred to Wexpro from Mountain Fuel were non-utility under the classification system customarily in use. In light of the totality of the proceeding and the extensive evidence received on the issues as framed, to now hold as suggested by the dissent on the questions of jurisdcition (sic) and classification might, itself, be considered "regulatory outrage".

Fifthly, the dissent unfairly claims that the Report and Order herein turns over to counsel for Mountain Fuel, "without any restraint whatsoever", the prerogative to establish the regulatory policy of this Commission and that it was motivated by fear of the actions of Mountain Fuel shareholders. The massive record of this case of better than a year, with the rehearing held and much evidence received over the strong objection of Mountain Fuel, totally disproves any such proposition. The dissent well knows that the Commission following the October 28, 1977 hearing requested counsel to submit proposed forms of a

Report and Order. Such request was in accordance with long established and well accepted practice of this Commission, as well as of the courts of this State, as we understand it. Counsel for Mountain Fuel as well as counsel for the Division submitted proposed findings, conclusions and orders, and all participants submitted comments on the drafts. The commission made various changes in the proposed drafts as submitted by counsel and such are reflected in the Report and Order as issued. Mountain Fuel and the Division being represented by able counsel in the case and the Commission being without any legal assistance to prepare its own draft, the Commission was justified in following accepted practice and in drawing from the essential drafts submitted by counsel. Such did not and does not delegate to any counsel in this case the authority to establish the policy or philosophy of this Commission. That responsibility as to the decision made is ours and ours alone.

Lastly, the announcement in the dissent that unreasonable time restraints were placed upon the dissenting Commissioner in the preparation of the dissent, is incorrect.The fact is that the Commissioner issued his initial dissent on October 28, 1977. Prior to the issuance of this Report and Order, the dissenting Commissioner had a full week in which he was relieved from hearing duties to prepare a final dissent. We must respectfully take exception to the motion that the dissent was required to be hastily written.

In conclusion, the factual issues at play in this case may afford room for differing views and conclusions. That there has in fact been a difference of opinion on the Commission in the matter is in some cases a positive sign that each Commissioner is performing his responsibilities. But

the fact that a difference of opinion has taken place on some points is no justification for an attack upon the integrity of the Commission or upon any individual Commissioner.

DATED at Salt Lake City, Utah this 17th day of April, 1978.

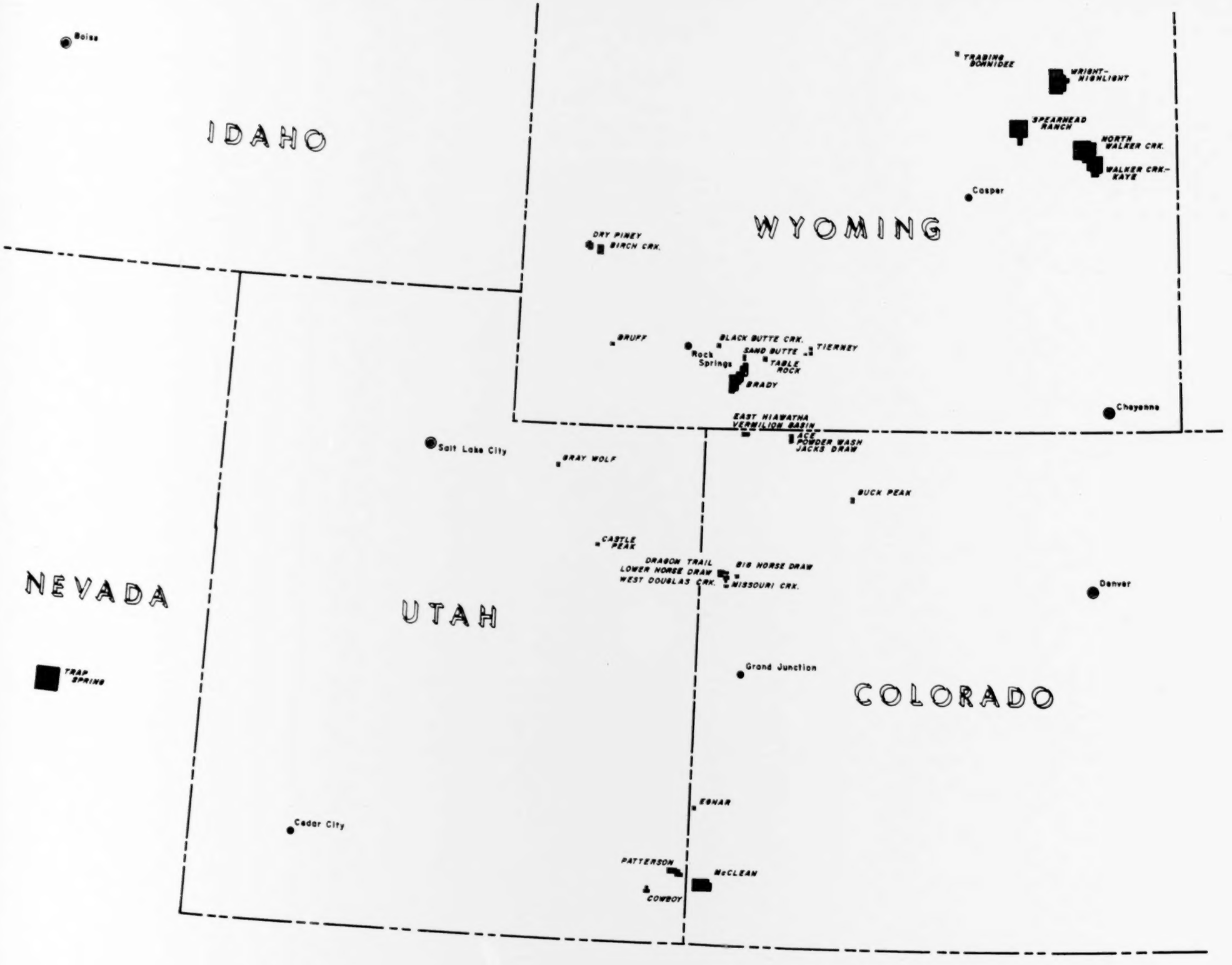
/s/ Milly O. Bernard, Chairman

(SEAL)

/s/ Olof E. Zundel, Commissioner

Attest:
/s/ Victor N. Gibb, Secretary

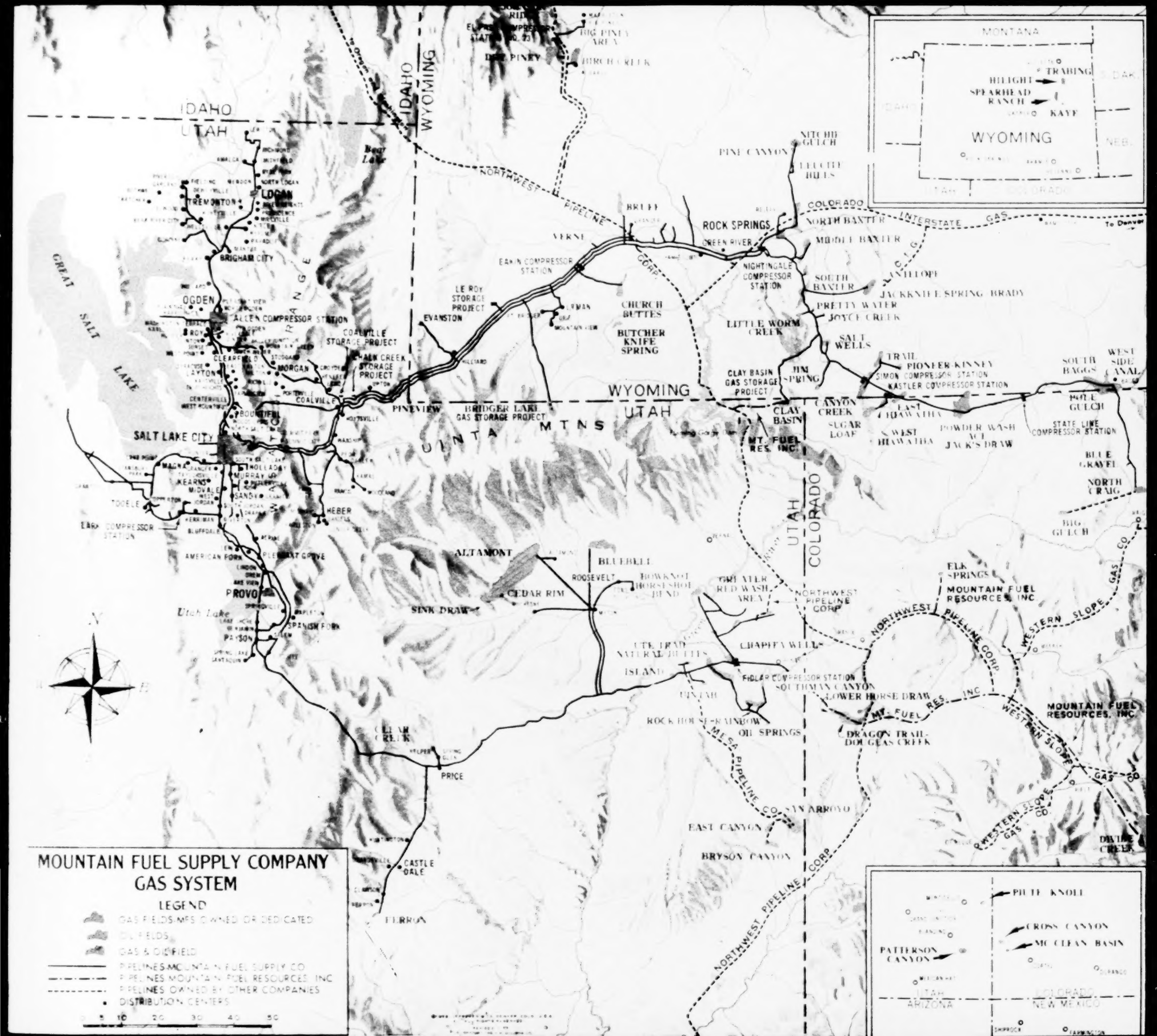
APPENDIX C



ATTACHMENT II WEXPRO PROPERTIES

■ Areas of Wexpro interest. Areas shown represent geographical locations only and not actual ownership as Wexpro shares ownership with many other parties in such areas.

APPENDIX D


MOUNTAIN FUEL SUPPLY COMPANY
GAS SYSTEM
LEGEND
GAS FIELDS MFS OWNED OR DEDICATED
OIL FIELDS
GAS & OILFIELD
PIPELINES MOUNTAIN FUEL SUPPLY CO.
PIPELINES MOUNTAIN FUEL RESOURCES, INC.
PIPELINES OWNED BY OTHER COMPANIES
DISTRIBUTION CENTERS
0 5 10 20 30 40 50
IDAHO
UTAH
WYOMING
COLORADO
ARIZONA
NEW MEXICO
MONTANA
NEBR.
GREAT SALT LAKE
Bear Lake
Utah Lake
WASATCH RANGE
UINTA MTNS
NORTHWEST PIPELINE CORP.
COLORADO INTERSTATE GAS
To Denver
WESTERN SLOPE GAS CO.
MESA PIPELINE CO.
NORTHWEST PIPELINE CORP
MOUNTAIN FUEL RESOURCES, INC
MT. FUEL RES. INC
LOGAN
TREMONTON
BRIGHAM CITY
OGDEN
ALLEN COMPRESSOR STATION
CLEARFIELD
LAYTON
MORGAN
COALVILLE
COALVILLE STORAGE PROJECT
ALEN CREEK STORAGE PROJECT
LE ROY STORAGE PROJECT
EVANSTON
EARA COMPRESSOR STATION
PINEVIEW
BRIDGER LAKE GAS STORAGE PROJECT
SALT LAKE CITY
MAGNA
KEARNS
MIDVALE
MURRAY
HOLLADAY
SANDY
TOOELE
HEBER
BLUFFDALE
AMERICAN FORK
PLEASANT GROVE
PROVO
SPRINGVILLE
SPANISH FORK
PAYSON
ALTAMONT
BLUEBELL
ROOSEVELT
BOUNDARY
CEDAR RIM
SINK DRAW
GREATER RED WASH AREA
NORTHWEST PIPELINE CORP
CHAPITA WELLS
ISLAND
FIDLAR COMPRESSOR STATION
SOUTHMAN CANYON
LOWER HORSE DRAW
DRAGON TRAIL-DOUGLAS CREEK
ROCK HOUSE-RAINBOW OIL SPRINGS
CLEAR CREEK
PRICE
CASTLE DALE
EMERY
SAN ARROYO
EAST CANYON
BRYSON CANYON
DIVIDE CREEK
BIG PINEY AREA
BIG PINEY
BIRCH CREEK
EL PASO COMPRESSOR STATION NO. 23
BRUFF
VERNAL
EARA COMPRESSOR STATION
ROCK SPRINGS
GREEN RIVER
NITCHIE GULCH
PINE CANYON
LEUCITE HILLS
NORTH BAXTER
MIDDLE BAXTER
SOUTH BAXTER
NIGHTINGALE COMPRESSOR STATION
ANTELOPE
JACKKNIFE SPRING BRADY
PRETTY WATER
JOYCE CREEK
LITTLE WORM CREEK
SALT WELLS
CHURCH BUTTES
BUTCHER KNIFE SPRING
CLAY BASIN GAS STORAGE PROJECT
HM SPRING
TRAIL
PIONEER KINNEY
SIMON COMPRESSOR STATION
KASTLER COMPRESSOR STATION
CANYON CREEK
SUGAR LOAF
CLAY BASIN
MT. FUEL RES. INC.
EAST HIAWATHA
SWEST HIAWATHA
POWDER WASH
ACI
JACK'S DRAW
SOUTH BAGGS
WEST SIDE CANAL
HOLE GULCH
STATE LINE COMPRESSOR STATION
BLUE GRAVEL
NORTH CRAIG
BIG GULCH
ELK SPRINGS
MOUNTAIN FUEL RESOURCES, INC
WESTERN SLOPE GAS CO.
NORTHWEST PIPELINE CORP.
TRABING
HELIGHT
SPEARHEAD RANCH
KAYE
PILOT KNOLL
CROSS CANYON
MC CLEAN BASIN
PATTERSON CANYON

APPENDIX E

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution

Article I, Section 8

> The Congress shall have Power . . . to regulate Commerce . . . among the several States . . . .

Article VI

> . . . the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Fifth Amendment

> . . . nor shall any person . . . be deprived of . . . property, without due process of law; nor shall private property be taken for public use, without just compensation.

Fourteenth Amendment, Section 1

> . . . nor shall any State deprive any person of . . . property, without due process of law . . . .

United States Statutes

Natural Gas Act, 15 U.S.C. §717(b)

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transporation or sale . . . .

Emergency Petroleum Allocation Act, 15 U.S.C. §§751 and 753

15 U.S.C. § 751. Congressional findings and declaration of purpose

(a) The Congress hereby determines that—

(1) shortages of crude oil, residual fuel oil, and refined petroleum products caused by inadequate domestic production . . . now exist or are imminent;

(2) such shortages have created or will create severe economic dislocations and hardships . . . ; and

(3) such hardships and dislocations jeopardize the normal flow of commerce and constitute a national energy crisis which is a threat to the public health, safety, and welfare and can be averted or minimized most efficiently and effectively through prompt action by the Executive branch of Government.

(b) The purpose of this chapter is to grant to the President of the United States and direct him to exercise specific temporary authority to deal with shortages of crude oil . . . . The authority granted under this chapter shall be exercised for the purpose of minimizing the adverse impacts of such shortages . . . on the American people and the domestic economy.

15 U.S.C. § 753. Mandatory allocation

Authority to promulgate regulations covering crude oil, residual fuel oil, and refined petroleum products

(a) Not later than fifteen days after

November 27, 1973, the President shall promulgate a regulation providing for the mandatory allocation of crude oil . . . in amounts specified in . . . and at prices specified in . . . such regulation. . . . Such regulation shall apply to all crude oil . . . produced in . . . the United States.

Requisite areas of coverage for regulations; price regulations; unobtainability or curtailment of other fuels; limitations on pricing policy

(b) (1) The regulation under subsection (a) of this section to the maximum extent practicable, shall provide for—

. . . .

(D) preservation of an economically sound and competitive petroleum industry; including the priority needs to restore and foster competition in the producing . . . [sector] of such industry . . . .

. . . .

(H) economic efficiency; and

(I) minimization of economic distortion, inflexibility, and unnecessary interference with market mechanisms.

Energy Policy and Conservation Act, 15 U.S.C. §§757 and 760g and 42 U.S.C. 6201

15 U.S.C. § 757. Oil pricing policy

Presidential authority to promulgate amendment to regulation establishing ceiling prices applicable to any first sale of crude oil produced in United States; resulting maximum weighted average first sale price

(a) Not later than the first day for the second full calendar month following December

22, 1975, the President shall promulgate and make effective an amendment to the regulation under section 753(a) of this title which regulation, as amended shall establish ceiling prices . . . applicable to any first sale of crude oil produced in the United States, such that the resulting actual weighted average first sale price for all such crude oil during such calendar month and each of the 39 months thereafter shall not exceed a maximum of $7.66 per barrel (hereinafter in this section referred to as the "maximum weighted average first sale price"), except as may be adjusted pursuant to this section.

Standards used in determining prices and classifications in Presidential amendment to regulation establishing ceiling prices; increase in price for any volume of old crude oil production; definition of old crude oil production

(b)(1) The regulation under section 753(a) of this title, as amended pursuant to subsection (a) of this section or by any subsequent amendment thereto, may, subject to the limitations related to the maximum weighted average first sale price and other requirements of this section, provide for different ceiling prices . . . for different classifications of crude oil produced in the United States. In providing for different ceiling prices . . . and classifications for such crude oil, the President shall determine that such ceiling prices . . . and such classifications—

. . . .

(B) are justified on the basis that such prices and such classifications are consistent with obtaining optimum production of crude oil in the United States.

(2) No amendment to the regulation under section 753(a) of this title made after December 22, 1975, may permit, in any month which begins after such date, an increase in the price for any volume of old crude oil production from any priorities, unless the President finds that such amendment—

(A) will give positive incentives for (i) enhanced recovery techniques, or (ii) deep horizon development, from such properties; or

(B) is necessary to take into account declining production from such properties; and

(C) is likely to result in a level of production from such properties beyond that which would otherwise occur if no such amendment were made.

Effective date and considerations of adjusted GNP deflator and production incentive in determining adjustments in maximum weighted average first sale price by Presidential amendment to regulation; definition of adjusted GNP deflator; prerequisite for applicability of production incentive in adjustment

(d)(1) The amendment promulgated pursuant to subsection (a) of this section (or any subsequent amendment to the regulation under section 753(a) of this title) may provide for an adjustment to the maximum weighted average first sale price specified in subsection (a) of this section, such adjustment to begin no earlier than in the calendar month following the first month the amendment is in effect—

. . . .

(B) as a production incentive. . . .

(3) The adjustment as a production incentive referred to in paragraph (1)(B) may be made only on a finding by the President that such an adjustment is likely to provide positive incentive for—

(A) the discovery or development of high cost and high risk properties (including new wildcat properties, and properties located on the Outer Continental Shelf, properties located north of the Arctic Circle, deep wells and deep horizons in onshore or offshore properties, and properties operated by independent producers);

(B) the application of enhanced recovery techniques to producing properties to obtain a level of production higher than would otherwise occur from those properties but for such adjustment; or

(C) sustaining production from marginal wells, including production from stripper wells.

15 U.S.C. § 760g. Conversion date of Presidential authority from mandatory to discretionary to promulgate, etc., regulation; termination date of Presidential authority limitations; expiration date of Presidential authority to promulgate, etc., regulation or issue order; effect on pending actions

Notwithstanding any other provision of this chapter, at midnight on the conclusion of the 40th month in which the amendment under section 757(a) of this title is in effect, the President's authority to promulgate, make effective, and amend a regulation pursuant to section 753(a) of this title shall become discretionary rather than mandatory, and the limitations on the President's authority contained in sections 753(b)(2), 757 and 758 of this title shall terminate. The authority to promulgate and amend any regulation or to issue any order under this chapter shall expire at midnight September 30, 1981 . . . .

42 U.S.C. § 6201. Congressional statement of purpose

The purposes of this chapter are—

. . . .

(3) to increase the supply of fossil fuels in the United States through price incentives and production requirements . . . .

Natural Gas Policy Act, 15 U.S.C. §3301(21)

15 U.S.C. § 3301(21) First sale.—

(A) General rule.—The term "first sale" means any sale of any volume of natural gas—

(i) to any interstate pipeline or intrastate pipeline;

(ii) to any local distribution company;

(iii) to any person for use by such person;

(iv) which precedes any sale described to clauses (i), (ii), or (iii) . . . .

(B) Certain sales not included.—Clauses (i), (ii), (iii), or (iv) of subparagraph (A) shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to

volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof.

Utah Statutes

Utah Public Utilities Act, §54-2-1(30) Utah Code Ann. (Repl. Vol. 6A 1974)

54-2-1(30) Utah Code Ann.

Except, as hereinafter provided, when any person or corporation performs any such service for or delivers any such commodity to any public utility herein defined, such person or corporation, and each thereof, is hereby declared to be a public utility and to be subject to the jurisdiction and regulation of the commission and to the provisions of this title. Any corporation or person not engaged in business exclusively as a public utility as hereinbefore defined shall be governed by the provisions of this title in respect only to the public utility or public utilities owned, controlled, operated or managed by it or by him, and not in respect to any other business or pursuit.

Supreme Court, U. S.
FILED
NOV 28 1979
K, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY, WEXPRO COMPANY, and ALEX OBLAD, HAROLD BURTON, and CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and UTAH DEPARTMENT OF BUSINESS REGULATION, DIVISION OF PUBLIC UTILITIES,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF UTAH

BRIEF IN OPPOSITION

ROBERT B. HANSEN
Attorney General of the State of Utah
State Capitol Building
Salt Lake City, UT 84114

DANIEL L. BERMAN
JAY D. GURMANKIN
Special Assistant Attorneys General
500 Kearns Building
Salt Lake City, Utah 84101

JAMES L. BARKER
Assistant Attorney General of the State of Utah
State Capitol Building
Salt Lake City, UT 84114
Counsel for Utah Committee of Consumer Services

STEPHEN R. RANDLE
Assistant Attorney General of the State of Utah
State Capitol Building
Salt Lake City, Utah 84114
Counsel for Utah Department of Business Regulation, Division of Public Utilities

November, 1979

TABLE OF CONTENTS

Page

INTRODUCTION 1

QUESTIONS PRESENTED 2

STATEMENT OF THE CASE 3

1. Mountain Fuel always conducted its oil and gas exploration program as a utility activity .. 4

2. It was only after the successful discovery of oil that Mountain Fuel attempted to reclassify its oil properties as non-utility properties under Mountain Fuel's wholly-unique oil and gas method of classification 6

3. Utah's ratepayers bore all of the risk of Mountain Fuel's exploration for oil and gas .. 9

4. The Wexpro transactions 12

5. The decision of the Utah Supreme Court 14

6. The decision of the Utah Supreme Court does not confiscate any property of Mountain Fuel or its shareholders, interfere with interstate commerce or conflict with federal energy policy 16

REASONS FOR DENYING THE WRIT 19

1. The Utah Supreme Court's decision does not raise any issue of constitutional confiscation 19

Page

2. The Utah Supreme Court's decision does not raise any issue of undue burden or obstruction of interstate commerce 23

3. The Utah Supreme Court's decision does not raise any issue of preemption 28

CONCLUSION 33

TABLE OF AUTHORITIES

Cases

Bebchick v. Washington Transit Commission, 485 F.2d 858 (D.C. Cir. 1973) 22, 23

Capital Transit Co. v. Public Utilities Commission of D.C., 213 F.2d 176 (D.C. Cir. 1953) 26

Cottonwood Mall Shopping Center v. Utah Power & Light Co., 440 F.2d 36 (10th Cir. 1971) 21-22

Dayton Power & Light Co. v. Public Utilities Commission of Ohio, 292 U.S. 290 (1934) 24, 29

Democratic Central Committee v. Washington Transit Commission, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974) 15, 22

El Paso Natural Gas Co., Docket No. CP75-362 (FERC 1977) 22, 23

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) 20-21

Page

Federal Power Commission v. Natural Gas Pipeline, 315 U.S. 575 (1942) 21, 22

Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 151 (1934) 21

Lone Star Gas Co. v. Texas, 304 U.S. 224 (1938) 24, 26, 29

Nebbia v. People of the State of New York, 291 U.S. 502 (1934) 21

New York Water Service Corp. v. Public Service Commission, 12 App. Div.2d 122, 208 N.Y.S.2d 857 (1960) 22, 23

Panhandle Eastern Pipeline Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951) 29

Panhandle Eastern Pipeline Co. v. Public Service Commission of Indiana, 332 U.S. 507 (1947) 29-30

Re Michigan Consolidated Gas Co., 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968) 15, 22, 23

Re Pacific Gas & Electric Co., 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n 1972) 15, 27

Re Wyoming Gas Co., 40 P.U.R.3d 509 (Wyo. Pub. Serv. Comm'n 1961) 22, 23

U. S. v. El Paso Natural Gas Co., 376 U.S. 651 (1964) 13

Page

Western Distributing Co. v. Public Service Commission of Kansas, 285 U.S. 119 (1932) 24-25, 29

Statutes

15 U.S.C. § 717-717w (1976 & Supp. 1979) 28-30

15 U.S.C. § 755(b) (1976) 31

15 U.S.C. § 3201, *et. seq.* (Supp. 1979) 30

15 U.S.C. § 3208 (Supp. 1979) 31

Utah Code Ann. §§ 40-6-1, *et seq.* (1974) 32

Utah Code Ann. §54-2-1(30) (1974) 18

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY, WEXPRO COMPANY, and ALEX OBLAD, HAROLD BURTON, and CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and UTAH DEPARTMENT OF BUSINESS REGULATION, DIVISION OF PUBLIC UTILITIES,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF UTAH

BRIEF IN OPPOSITION

INTRODUCTION

The Utah Division of Public Utilities and the Utah Committee of Consumer Services ("Utah") file this Brief in opposition to the petition for certiorari of Utah's principal natural gas utility, Mountain Fuel, and its af-

filiated petitioners ("Mountain Fuel").[1] Mountain Fuel seeks federal review of a Utah Supreme Court decision terminating a gross consumer fraud on Utah's citizens —a fraud the Utah court aptly characterized as a "regulatory outrage", in a manner wholly consonant with Utah's regulatory mandate and public policy without the remotest interference, let alone violation of any federal constitutional prescription.

QUESTIONS PRESENTED

1. Does the fourteenth amendment, the commerce clause or federal preemption prohibit Utah from treating Mountain Fuel's oil and gas properties located in Utah, Colorado and Wyoming as utility properties for rate-making purposes when those properties were explored and developed as utility properties pursuant to a utility exploration program at the risk of Utah's ratepayers?

2. Under the property guarantees of the fourteenth amendment does Mountain Fuel have the constitutional right to conduct an oil and gas exploration program as a utility activity, charge all of the risk of exploration to Utah ratepayers, and keep all the profits from oil discoveries for the sole benefit of Mountain Fuel's stockholders?

3. Does the fourteenth amendment require Utah to grant Mountain Fuel the best of both possible worlds,

[1] The amicus Mountain States Legal Foundation, which purports to present to the Court a "studied reflection" on this case, is financially supported by Mountain Fuel and has on its Board of Directors Wexpro's counsel.

that is, to treat the risk of oil and gas exploration as a utility activity to be borne solely by Utah's ratepayers, but the profits of successful oil discovery as the fruits of free enterprise to be enjoyed exclusively by Mountain Fuel's stockholders?

4. Was Utah constitutionally compelled to accept Mountain Fuel's totally unique "oil and gas method of classification" as the controlling principle for allocating the benefits from Mountain Fuel's oil and gas properties between ratepayer and stockholder interest?

5. Does federal preemption or the commerce clause deprive Utah of regulatory authority over a utility's oil and gas exploration program conducted in Utah and other states as a Utah utility activity at the sole risk of Utah's ratepayers upon the discovery of oil?

6. Is Utah's decision to apply the well-established principle of utility law—gain follows risk—in the allocation of benefits arising from utility activity between ratepayer and stockholder interest to Mountain Fuel's oil and gas properties barred by federal preemption or the commerce clause when those properties whether located in Utah or adjacent states were explored and developed as a Utah utility activity at the sole risk of Utah's ratepayers?

STATEMENT OF THE CASE

The sweeping questions Mountain Fuel attempts to present are contrary to the uncontroverted facts. Mountain Fuel's argument is fundamentally premised on three false factual assertions.

(1) Mountain Fuel claims Mountain Fuel conducted its oil and gas exploration program as a free enterprise, non-regulated activity. On the contrary, Mountain Fuel at all times conducted its exploration program as a utility activity.

(2) Mountain Fuel claims Mountain Fuel's shareholders bore the risk of its exploration for oil and gas. On the contrary, the ratepayers bore all the risk of Mountain Fuel's exploration for oil and gas.

(3) Mountain Fuel claims the decision of the Utah Supreme Court amounts to retroactive reclassification, whatever that is. On the contrary, the Utah decision does not recapture one dime of oil profits taken by Mountain Fuel's shareholders before the initiation of these proceedings, and only classifies as utility properties for future rate-making purposes, properties that always were and should have been so classified.

1. *Mountain Fuel always conducted its oil and gas exploration program as a utility activity.*

From the inception, Mountain Fuel conducted its oil and gas exploration program as a Utah utility activity. Unlike major oil companies, independent producers, or indeed other utilities, Mountain Fuel did not put up its shareholders' money and take its chances. Mountain Fuel let Utah ratepayers put up their money and take the chance of finding oil or gas. All of the wildcat acreage Mountain Fuel explored was acquired

by Mountain Fuel in its utility accounts and included in Mountain Fuel's rate base on which Mountain Fuel's ratepayers paid a regulated rate of return. (R. 700.)[2] If leases proved unsuccessful and were cancelled, the loss on such cancellation was charged to Mountain Fuel's ratepayers. (R. 687-88.) All preliminary exploratory work was charged as an expense in Mountain Fuel's rates. Most important of all, every single dry hole was charged to Mountain Fuel's Utah ratepayers. (Utah P.S.C. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; R. 312-14, 687-89, 691, 701, 2394.) From 1947 until 1974 Mountain Fuel recovered all of its expense for the exploration and development of oil and gas through charges in its rates to Utah ratepayers and in fact the amount recovered actually exceeded the amount of expense incurred by Mountain Fuel in its exploration activities. (Utah P.S.C. Case Nos. 6668 and 6791 (1974); R. 694.)[3] Mountain Fuel did conduct its exploration program in states other than Utah, but the uncontroverted facts were that that exploration program, wherever conducted—in Utah, Wyoming, or Colorado—was con-

---

[2] The following abbreviations are used for the purpose of citation in this brief: (1) "R." refers to the transcript page numbers from evidentiary hearings before the Public Service Commission; (2) "Ord." by date and without case number refers to the orders of the Public Service Commission in this case; (3) orders by case number and date only refer to Commission orders in the cited case, and (4) citations to exhibits are to the exhibit number used in this proceeding; Mountain Fuel exhibits are referred to as MFS—; Division of Public Utilities exhibits are referred to as DIV—; and Salt Lake County exhibits are referred to as SLC—.

[3] For accounting purposes, the costs of unsuccessful exploration are expensed and the costs of successful exploration are capitalized. Mountain Fuel's shareholders only put their money up after exploration proved to be successful.

ducted as a Utah utility activity, and Mountain Fuel only attempted to transform its exploration program from a utility to a non-utility classification after oil and gas were discovered.

2. *It was only after the successful discovery of oil that Mountain Fuel attempted to reclassify its oil properties as non-utility properties under Mountain Fuel's wholly-unique oil and gas method of classification.*

While Mountain Fuel explored for oil and gas as a utility activity, it attempted to transform successful oil discoveries into non-utility properties beyond regulatory control under its wholly-unique oil and gas method of classification. (R. 1030-31.) Under Mountain Fuel's oil and gas method of classification, a successful exploration was classified as an oil or gas well based on the type of hydrocarbon discovered. (MFS-5; R. 71-72, 422, 455, 559, 1030-31.) If a commercial discoverey produced pipeline quality gas, the well and related properties were capitalized in Mountain Fuel's utility accounts and the gas distributed to Mountain Fuel's ratepayers as cost-of-service gas, which included, of course, a profit or rate of return on Mountain Fuel's capital investment. (MFS-5; R. 61.) All other hydrocarbons, whether crude oil, condensate, or natural gas liquids were classified by Mountain Fuel as oil properties and capitalized by Mountain Fuel in its non-utility accounts. (R. 1030-31; 1045.) Mountain Fuel kept all of the profits from these oil properties exclusively for Mountain Fuel's shareholders. (SLC-1 at 8; R. 1030-31.)

Mountain Fuel's oil and gas method of classification was thus used by Mountain Fuel for two purposes. First, it was used by Mountain Fuel as a test of Utah's regulatory jurisdiction. That is, under Mountain Fuel's oil-and-gas method of classification, Mountain Fuel claimed Utah lost regulatory jurisdiction upon Mountain Fuel's discovery of hydrocarbons other than pipeline gas. (Ord. 4/11/78 at ¶¶ 11, 52, 108.) Mountain Fuel also used its oil and gas method of classification as a principle of allocating the benefits of its exploration program between ratepayer and stockholder interests. (SLC-1 at 8; R. 1030-31.) Although all of Mountain Fuel's exploration program for oil and gas was conducted as a unitary utility activity, Mountain Fuel's ratepayers only benefited upon the discovery of gas.[4] The ratepayers benefited upon gas discoveries by having such gas included in their rates at a cost-of-service price rather than field or market prices. The cost-of-service price, of course, included a profit for Mountain Fuel's stockholders. Although Mountain Fuel conducted its exploration as a utility activity under its oil and gas method of classification, it kept all oil discoveries

---

[4] Utah did not argue that Mountain Fuel's exploration program had failed to benefit Utah ratepayers. Utah's argument was that Mountain Fuel's shareholders, under Mountain Fuel's oil and gas method of classification, realized huge oil profits to which they were not entitled. Mountain Fuel, moreover, in its petition, grossly overstates the benefits received by Utah's ratepayers. Mountain Fuel, in its petition, for instance, claims that Utah ratepayers received some $93.8 million in tax deductions from Mountain Fuel's exploration program. (Petition at 9.) But the $93.8 million includes all of Mountain Fuel's costs of unsuccessful exploration that were, in turn, charged to Utah's ratepayers to the tune of $57 million. Simply, Mountain Fuel claims that it was to the ratepayers' benefit to pay for the cost of drilling dry holes.

for the sole benefit of Mountain Fuel's stockholders. In short, Mountain Fuel used its oil and gas method of classification to achieve the best of both possible worlds. When it was involved in the high-risk business of exploring for oil and gas, it conducted that business as a utility activity and charged those risks to Utah's ratepayers. When the risk of exploration was eliminated and it had discovered oil, Mountain Fuel attempted to convert its oil wells to non-utility properties and to keep the benefits or profits from those properties as the fruits of free enterprise exclusively for its stockholders. To look at the consequences of Mountain Fuel's oil and gas method of classification in the harsh light of economic reality, it was Mountain Fuel's position that Mountain Fuel was able to develop over $250 million in oil reserves for the sole benefit of Mountain Fuel's stockholders without drilling a single dry hole.

Mountain Fuel's claim that its oil and gas method of classification was required by utility regulation and that its rejection will have economic and litigation repercussions beyond this one proceeding are wholly false. Mountain Fuel's oil and gas method of classification was not required by any rule or regulation. (R. 230, 231, 1029.) Indeed it was only after the initiation of these proceedings in 1977 that Mountain Fuel's oil and gas method of classification was ever reduced to writing. (Ord. 4/11/78 at ¶ 22; MFS-4, 5; R. 286.) Mountain Fuel's own chief executive officer acknowledged that while Mountain Fuel was required under standard utility regulation to keep separate utility and non-utility accounts, there was no rule or regulation that required

the division of Mountain Fuel's oil and gas properties between such accounts on the basis of Mountain Fuel's oil and gas method of classification. (R.231.) The reason there was no such accepted rule or regulation is because Mountain Fuel's oil and gas method of classification was wholly unique not only to the gas utility industry but to the entire oil and gas industry. No other company in the United States has ever used Mountain Fuel's oil and gas method of classification as a test of regulatory jurisdiction or as a principle for allocating benefits between ratepayer and shareholder interests. (R. 295-96; 459-61; 870-71; 2707.) The uniqueness of Mountain Fuel's oil and gas method of classification now belies Mountain Fuel's claim that Utah's rejection of that method of classification raises constitutional questions of substance for this Court's consideration or to put the issue in different perspective, belies Mountain Fuel's necessary position that the consequences of its oil and gas method of classification were compelled under the United States Constitution.

3. *Utah's ratepayers bore all of the risk of Mountain Fuel's exploration for oil and gas.*

The risk of exploration for oil and gas is the risk of not finding oil or gas. All of the risk of oil and gas exploration is reflected in the cost of unsuccessful exploration and all of the cost of unsuccessful exploration by Mountain Fuel was charged by Mountain Fuel in its rates to Utah ratepayers. From 1947 until 1972 Utah ratepayers did not merely pay Mountain Fuel for the gas they used but also paid all of Mountain Fuel's cost for unsuccessful exploration—every single dry hole.

(Utah P.S.C. Case Nos. 2906 (1947), 4797 (1960) and 6369 (1972); DIV-1; MFS-8; R. 312-14, 687-89, 691, 701, 2394.)

Mountain Fuel's shareholders or non-utility accounts were not required to pay one single dime toward Mountain Fuel's cost of unsuccessful exploration until 1972. In 1972, the Utah Public Service Commission for the first time required Mountain Fuel's non-utility accounts, representing the interest of Mountain Fuel's shareholders, to pay $300,000 a year toward Mountain Fuel's cost of unsuccessful exploration. (Utah P.S.C. Case No. 6369 (1972); R. 688.) In 1974 Mountain Fuel's non-utility accounts were required to pay 1/3 of such cost (Utah P.S.C. Case No. 6668 (1974) and finally in 1976, only one year before the Wexpro transactions, Mountain Fuel's stockholders were required to bear 50% of Mountain Fuel's risk of exploration. (Utah P.S.C. Case No. 7113 (1975); R. 688-89.)

From 1947 through 1974 the amount charged in Mountain Fuel's rates to Utah's ratepayers for the cost of unsuccessful exploration exceeded by over $3 million the amount Mountain Fuel actually spent or incurred for unsuccessful exploration. (Utah P.S.C. Case Nos. 6668, 6791 (1974); R. 694.) In short, through 1974, Utah ratepayers bore all of Mountain Fuel's risk of exploration for oil and gas. By 1974 Mountain Fuel had already completed its major oil and gas discoveries. (Ord. 4/11/78 at ¶¶ 27-29.) Of the $250 million in oil and gas reserves that Mountain Fuel attempted to transfer from its non-utility accounts to Wexpro in December

of 1976, over 96% of those reserves had been discovered by 1974. (Ord. 4/11/78 at ¶¶ 27-29; DIV-2; R. 1012, 1025.)

It is true that in 1972 Mountain Fuel's non-utility accounts were required to commence making token contributions to Mountain Fuel's exploration risk and that from 1972 through 1976 Mountain Fuel's shareholders, through its non-utility accounts, finally paid over $8 million toward Mountain Fuel's risk of exploration. (DIV-1.) In the same 1972-1976 period, however, Mountain Fuel's ratepayers paid $17 million toward Mountain Fuel's cost of unsuccessful exploration (*Id.*) and from 1947 through 1976 the ratepayers paid over $57 million. (Utah P.S.C. Case Nos. 2906 (1947), 3275 (1948), 3511 (1950), 3650 (1951), 3972 (1953), 4392 (1957), 4797 (1960) and 5907 (1968); DIV-1; MFS-8.) More importantly, the shareholders' contribution that was finally required was only paid out of the enormous profits from oil properties that had been discovered at ratepayer risk. In 1972 Mountain Fuel had net profits from its non-utility oil properties of $1.6 million; in 1973, $2.3 million; in 1974, $7.2 million; in 1975, $14.4 million; and in 1976, the year before Wexpro, $24 million. (SLC-1 at 8.) In the period, 1972-1976, when Mountain Fuel was finally required to pay $8 million toward Mountain Fuel's cost of unsuccessful exploration it realized over $47 million in net profits from the oil properties that had been developed at the sole risk of Mountain Fuel's ratepayers. Mountain Fuel's costs of unsuccessful exploration were, thus, either directly paid by Utah ratepayers or paid from the prof-

its of oil properties that had been developed at the sole risk of Utah ratepayers. The total risk, therefore, of Mountain Fuel's exploration and development of oil and gas was in economic reality borne by the Utah ratepayers of Mountain Fuel. It was this consumer fraud that was terminated by the Utah decision that Mountain Fuel now claims warrants review of this Court.

Mountain Fuel's claim, a claim made for the first time in this Court, that the risk of exploration charged to ratepayers was conditioned on the requirement that Mountain Fuel discover and produce cheap gas, is wholly false. The ratepayers' obligation to pay all of Mountain Fuel's cost of unsuccessful exploration was not conditioned in any way. If Mountain Fuel had not discovered a single cubic foot of gas, Mountain Fuel and its stockholders would not have had to reimburse or defray any of the burden placed on Utah's ratepayers. The record is wholly devoid of any such administrative requirement. There was simply no money-back guarantee.

4. *The Wexpro transactions.*

Effective January 1, 1977, Mountain Fuel attempted to once and for all remove the oil and gas properties held in its non-utility accounts from what it perceived as the jeopardy of Utah regulation. Mountain Fuel created a wholly-owned subsidiary, Wexpro, and attempted to transfer all of the oil and gas reserves held in its non-utility oil accounts with a market value in excess of $250 million to Wexpro. Mountain Fuel also attempted to have Wexpro enter into a joint exploration arrangement with Mountain Fuel to explore over 2.9 million acres of oil and gas leases held in Mountain Fuel's utility accounts. The transfer of Mountain Fuel's oil and gas properties to Wexpro at book value in exchange for all of Wexpro's outstanding stock was reflected in a Purchase and Sale Agreement. (MFS-1.) The Purchase and Sale Agreement, as amended, required Wexpro to resell all of the gas produced from the transferred properties to Mountain Fuel at cost-of-service prices. (MFS-4.) The Purchase and Sale Agreement also gave Mountain Fuel an option to purchase gas produced by Wexpro on new acreage at market prices. The joint exploration arrangement was reflected in a Joint Exploration Agreement between Mountain Fuel and Wexpro. (MFS-2, 5.)

The respondents initiated the proceedings below to attack the Wexpro transactions. Utah claimed that the Commission had jurisdiction over the oil and gas properties held in Mountain Fuel's non-utility accounts, that such properties were utility properties, and that they should be rolled in or included in Mountain Fuel's utility accounts for rate-making purposes. The Public Service Commission, in a 2-1 decision,[5] ruled against respondents, and they appealed to the Utah Supreme Court.

---

[5] The Commission Report & Order set forth at pages 1 to 95 of Appendix B to Mountain Fuel's petition does not represent the independent product of the Public Service Commission but was adopted verbatim from the order proposed by Mountain Fuel, an adjudicatory practice previously critized by this Court. **U.S. v. El Paso Natural Gas Co.**, 376 U.S. 651 (1964).

5. The decision of the Utah Supreme Court.

The Utah Supreme Court reversed the Utah Public Service Commission. The holdings of the Utah Supreme Court below can be divided for the purpose of the petition for certiorari between holdings addressed to issues relating to the oil and gas properties held in Mountain Fuel's non-utility accounts and holdings addressed to the option of Mountain Fuel to purchase gas produced by Wexpro from newly-acquired acreage at market prices and Wexpro's regulatory status. The holdings of the Utah Supreme Court addressed to the oil and gas properties were by far the most important and were the focus of the court's decision. These holdings were clear and final.

The Utah Supreme Court held with regard to the oil and gas properties held in Mountain Fuel's non-utility accounts (1) such properties were utility properties (App. A12),[6] and (2) such properties should be included in Mountain Fuel's utility accounts for rate-making purposes (App. A8, 9). The Supreme Court of Utah categorically rejected Mountain Fuel's oil and gas method of classification as a proper test of Utah regulatory jurisdiction or as a proper principle for the allocation of benefits arising from Mountain Fuel's oil and gas exploration program between ratepayer and shareholder interest. The bottom line of the Utah Supreme Court's decision was that the net profits from Mountain Fuel's oil properties beyond all costs associated with their production, including the cost of capital, should be applied to the benefit of Utah ratepayers through a reduction in their future rates (App. A8, 9). The court held the ratepayers were to receive those net profits because the ratepayers and not Mountain Fuel's shareholders had assumed the risk of exploration for oil and gas (App. A8). The Utah court reached the same result as Michigan and California. *Re Michigan Consolidated Gas Co.*, 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968); *Re Pacific Gas & Electric Co.*, 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n 1972), and implicitly followed the thoughtful decision of the Circuit Court of Appeals for the District of Columbia in *Democratic Central Committee v. Washington Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974).

The Utah Supreme Court's holding with regard to Mountain Fuel's option to purchase gas from Wexpro at market prices was occasioned by the past practices of Mountain Fuel. When gas reserves wound up in Mountain Fuel's non-utility accounts as a result of Mountain Fuel's oil and gas method of classification, Mountain Fuel added insult to injury by reselling that gas to Mountain Fuel's utility accounts at market prices, and then passing on those market prices as an expense in its rates to Utah ratepayers. The Supreme Court of Utah, in light of these past practices, adopted a "no-profit-to-affiliates" rule which prohibited such intra-company profits from being included in consumer rates, and applied that rule to the Mountain Fuel-Wexpro option so as to prevent any profit realized by Wexpro

[6] The citation "App. A" refers to the Utah Supreme Court's decision set forth in Appendix A to Mountain Fuel's Petition for a Writ of Certiorari.

under that option from being passed on to Mountain Fuel's ratepayers. The Utah Supreme Court also held that Wexpro, by reason of its relationship as a wholly-owned subsidiary of Mountain Fuel and the unique relationship between Mountain Fuel and Wexpro created under the Purchase and Sale Agreement and the Joint Exploration Agreement, was, under Utah law, a public utility.

While the Supreme Court's holding with regard to the Mountain Fuel-Wexpro option and Wexpro's status as a public utility are clear, their finality for the purpose of certiorari is less certain. The Supreme Court not only set aside the Purchase and Sale Agreement and the Joint Exploration Agreement, the Supreme Court of Utah left open the question of whether Wexpro is to exist at all. Specifically, in footnote 8, the Utah court said:

> There is further posed the serious issue of whether it is in the public interest for Mountain Fuel to divide its utility function between itself and a subsidiary. Relevant factors to be considered in this inquiry include any potential administrative inconvenience caused by the necessity of regulating two corporate entities performing, in essence, a singular utility function; and additional costs and expenses affecting the rate base.

Simply put, the question of whether there is going to be a Wexpro remains a Utah regulatory issue.

6. *The decision of the Utah Supreme Court does not confiscate any property of Mountain Fuel or its shareholders, interfere with interstate commerce or conflict with federal energy policy.*

Mountain Fuel's attempt to concoct "substantial Federal questions" out of the decision below is premised on fundamental mischaracterization of the court's decision. The Utah Supreme Court's decision did not confiscate anything. The Utah Supreme Court merely held that oil and gas properties that had been developed under a utility program at the risk of Utah ratepayers were utility properties on which Mountain Fuel was only entitled to a regulated rate of return, and that net profits beyond that regulated rate of return should be credited to Mountain Fuel's ratepayers to reduce rates. What Mountain Fuel's shareholders are entitled to have constitutionally protected and what will be protected under the decision of the Utah Supreme Court is their capital investment in Mountain Fuel's utility oil properties.

The decision below does not "retroactively reclassify" anything. Mountain Fuel's attempt to inject the slogan "retroactive reclassification" to support its "confiscation" argument is sophistry. Nothing in the Utah court's holding will affect anything prior to the institution of the *Wexpro* proceeding. There is no impact on rates received or revenues realized under any prior Commission order. Mountain Fuel will keep every dime of the $57 million it received for the cost of unsuccessful exploration. It will keep every dime of oil profits it received through the end of 1976—profits amounting to over $47 million. The court's decision will only affect rates and revenues after the initiation of the *Wexpro* case.

The Utah decision did not regulate the price, pro-

duction or profits of oil and gas sold in interstate commerce. The Utah decision did not remotely attempt to regulate the price at which oil or gas is sold by Mountain Fuel or Wexpro to others, nor does it even regulate the price at which Wexpro sells gas to Mountain Fuel under the Mountain Fuel-Wexpro option. All that the Utah Supreme Court held with regard to the Wexpro-Mountain Fuel sales is that any profits realized by Wexpro could not be included as charges in Mountain Fuel's rates to Mountain Fuel's customers under the "no-profit-to-affiliates" rule.

By holding that the unique relationship between Mountain Fuel and Wexpro resulted in Wexpro being classified as a public utility, the Utah Supreme Court did not hold and did not even state that independent parties other than Wexpro would be classified as public utilities by reason of their normal business relationships with Mountain Fuel. The Utah Supreme Court did not attempt to regulate the price of natural gas sold to Mountain Fuel for resale by independent parties or to classify such independent suppliers as public utilities. Indeed, Utah has a statute that expressly exempts such independent suppliers from classification as a public utility. Thus, section 54-2-1(30) provides in material part:

> Such person, company, corporation or association selling or exchanging such surplus product under such authorized contract shall not thereby become a public utility within the meaning of this act, nor shall it be subject to the jurisdiction of the commission. . . . § 54-2-1 (30), U.C.A. 1953.

And finally, the Utah Supreme Court's decision does not prevent any independent party from engaging in joint exploration with Mountain Fuel under the penalty of being classified as a public utility. Wexpro was not an independent party. Wexpro was created as a wholly-owned subsidiary of Mountain Fuel for the sole business purpose of receiving all of the oil and gas properties held in Mountain Fuel's non-utility accounts and to explore with Mountain Fuel the valuable wildcat acreage held in Mountain Fuel's utility accounts. It was intimately involved in an attempt to secure with finality hundreds of millions of dollars of oil and gas reserves that had been developed at ratepayer risk for the benefit of Mountain Fuel's shareholders, and to grab enormously valuable exploration rights on over 2.9 million acres of oil and gas leases held in Mountain Fuel's utility accounts. There was nothing independent about Wexpro, and there is nothing in the *Wexpro* decision by the Utah Supreme Court that regulates, threatens or interferes with independent producers or sellers.

REASONS FOR DENYING THE WRIT

1. *The Utah Supreme Court's decision does not raise any issue of constitutional confiscation.*

Mountain Fuel's claim of constitutional confiscation amounts to a claim that Mountain Fuel is constitutionally entitled in its exploration program to the best of both possible worlds—the worlds of utility regulation and private enterprise. Mountain Fuel under its "oil" and "gas" method of classification asked to be treated

as a utility when it was engaged in the risk of exploration. It wanted to be treated as a utility by having its wildcat acreage capitalized in its utility accounts as property held for future use, when it incurred losses on wildcat acreage by including as a charge in its rates the expenses of cancelled leases, when it did geophysical and seismic work preparatory to exploration, and when exploration was unsuccessful and resulted in dry holes. But Mountain Fuel wanted its exploration to be transformed into a private enterprise as soon as oil was discovered. It wanted to be treated as a private enterprise under its "oil" and "gas" method of classification where the benefits of profits of its oil properties were concerned.

The simple answer to Mountain Fuel's claim of constitutional confiscation is that the constitution does not guarantee a utility the best of both possible worlds. The constitution does not guarantee a utility can charge its ratepayers the cost of service for the gas they receive, in addition can charge its ratepayers for all the cost of unsuccessful exploration, and then keep the unregulated return from oil properties discovered through such exploration solely for the benefit of stockholders.

Under the Utah Supreme Court's decision Mountain Fuel and Mountain Fuel's stockholders receive the constitutional protection to which they are entitled. What Mountain Fuel's stockholders are entitled to have protected, and what will be protected under the Utah Supreme Court's decision, is their capital investment. ***Federal Power Commission v. Hope Natural Gas Co.,***

320 U.S. 591 (1944); *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); *see also, Nebbia v. People of the State of New York*, 291 U.S. 502 (1934). The roll-in of Mountain Fuel's utility oil properties and associated revenues and expenses under the Utah Supreme Court's decision will result in the full protection of Mountain Fuel's stockholders' capital investment in utility oil properties. All the costs associated with the operation and production of Mountain Fuel's utility oil properties, including a rate of return or profit on the stockholders' capital investment, will inure to the benefit of Mountain Fuel's stockholders. That is the protection required by the constitution and that is the protection that Mountain Fuel's stockholders will receive under the court's decision. What the stockholders will not receive are the net profits of Mountain Fuel's utility oil properties beyond all costs associated with their production. Beyond such costs those profits will be allocated to its ratepayers under the Utah Supreme Court's decision, for those profits are profits attributable to the risks of exploration, the risks that were exclusively borne by Mountain Fuel's ratepayers.

This Court has squarely held that there is no constitutional right to non-regulation and certainly there is no constitutional right to the continued acceptance of Mountain Fuel's oil and gas method of classification that arbitrarily and improperly removed utility properties from the jurisdiction of the Commission. ***Federal Power Commission v. Natural Gas Pipeline***, 315 U.S. 575 (1942); *Nebbia v. People of the State of New York, supra; Cottonwood Mall Shopping Center v. Utah*

Power & Light Co., 440 F.2d 36 (10th Cir. 1971). The argument that Mountain Fuel makes was precisely the constitutional attack made against the Natural Gas Act of 1938 which for the first time placed natural gas pipelines under federal regulation and made such pipelines subject to a regulated rate of return. The Court made short shrift of that argument and stated, "[T]he business . . . is not any the less subject to regulation now because the government has not seen fit to regulate it in the past." *Federal Power Commission v. Natural Gas Pipeline, supra*, at 583.

The roll-in of oil properties, revenues and expenses is not confiscation at all, but is an application by the Utah Supreme Court of the controlling principle uniformly followed by courts and commissions in allocating benefits arising from utility activities between ratepayer and stockholder—gain follows risk. *Democratic Central Committee v. Washington Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974); *Bebchick v. Washington Transit Commission*, 485 F.2d 858 (D.C. Cir. 1973); *New York Water Service Corp. v. Public Service Commission*, 12 App. Div.2d 122, 208 N.Y.S.2d 857 (1960); *El Paso Natural Gas Co.*, Docket No. CP75-362 (FERC 1977); *Re Michigan Consolidated Gas Co.*, 78 P.U.R.3d 321 (Mich. Pub. Serv. Comm'n 1968); *Re Wyoming Gas Co.*, 40 P.U.R.3d 509 (Wyo. Pub. Serv. Comm'n 1961). The principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom, *Democratic Central Committee, supra*, at 806, does not raise an issue of con-

fiscation, but is valid regulation of public utility activity in the public interest. This principle of allocation has been adopted without exception by every single judicial and administrative decision in every jurisdiction which has ever addressed the question. *Bebchick v. Washington Transit Commission, supra; New York Water Service Corp. v. Public Service Commission, supra; El Paso Natural Gas Co., supra; Re Michigan Consolidated Gas Co., supra; Re Wyoming Gas Co., supra.* The claim of "confiscation" is a red herring.

2. *The Utah Supreme Court's decision does not raise any issue of undue burden or obstruction of interstate commerce.*

Mountain Fuel's claim the Utah Supreme Court decision burdens or obstructs interstate commerce is wholly without merit.

(a) Mountain Fuel attempts to argue that the Utah Supreme Court's holding addressed to the Mountain Fuel-Wexpro option obstructs commerce by regulating the price of interstate sales of gas from Wexpro to Mountain Fuel.[7] The decision below does nothing of the sort. Rather, the Utah Supreme Court requires the Public Service Commission to allow in retail rates only the cost of service on gas sold by Wexpro to Mountain Fuel. The court does so under the "no-profit-to-affiliates" rule, applying the well-established principle that

---

[7] While the question whether Wexpro is to exist at all is still open, see § 5, supra, there is no commerce clause issue raised by this case whether Wexpro exists or not. For the purpose of respondents' argument respondents assume that Wexpro will be in business.

shareholders should not be able to make a profit at the expense of ratepayers on transactions between affiliated companies where there is no arm's-length bargaining. Regardless of whether or not Wexpro's gas comes from inside or outside Utah, this holding is fully in line with constitutional doctrine established by this Court. This Court has consistently held a state, in retail ratemaking, may determine a reasonable charge on interstate sales of natural gas between affiliates without violating the commerce clause. In *Lone Star Gas Co. v. Texas*, 304 U.S. 224 (1938), this Court expressly rejected the argument that a determination by the Texas commission of a reasonable rate for gas sold interstate to a utility by an affiliated pipeline company was invalid under the commerce clause. *Lone Star Gas* was consistent with and followed the rule laid down in *Dayton Power & Light Co. v. Public Utilities Commission of Ohio*, 292 U.S. 290 (1934) and *Western Distributing Co. v. Public Service Commission of Kansas*, 285 U.S. 119 (1932). In *Western Distributing*, the Court explained why a state inquiry into the reasonableness of a charge by an affiliate for gas sold interstate does not circumvent paramount federal authority over interstate commerce:

> Those in control of the situation have combined the interstate carriage of the commodity with its local distribution in what is in practical effect one organization. There is an absence of arm's length bargaining between the two corporate entities involved, and of all the elements which ordinarily go to fix market value. The opportunity exists for one member of the combination to charge the other an unreasonable rate for the gas furnished and thus to make such unfair charge in part the basis of the retail rate. The state authority whose powers are invoked to fix a reasonable rate is certainly entitled to be informed whether advantage has been taken of the situation to put an unreasonable burden upon the distributing company, and the mere fact that the charge is made for an interstate service does not constrain the Commission to desist from all inquiry as to its fairness. Any other rule would make possible the gravest injustice, and would tie the hands of the state authority in such fashion that it could not effectively regulate the intrastate service which unquestionably lies within its jurisdiction. *Western Distribution Co., supra,* at 124-25.

The Utah Supreme Court's holding on this point was especially sound in this case in light of the fact that in the past Mountain Fuel has actually been selling gas from its non-utility accounts to its utility accounts at market prices, and then passing on those market prices as an expense in rates to Utah ratepayers. The commerce clause under this Court's doctrine does not proscribe a state from putting a stop to that kind of practice.

(b) Mountain Fuel's argument that the roll-in of oil properties and profits obstructs commerce is based on a fundamental misstatement of the Utah Supreme Court's decision. Mountain Fuel misrepresents the court's holding by arguing that it regulates production, prices and profits on interstate sales of crude oil developed in states other than Utah. That is false. On the contrary, all the Utah Supreme Court held with regard to Mountain Fuel's oil profits is that net profits

beyond all costs associated with production, including the cost of capital, from oil developed as a utility activity at the sole risk of ratepayers, should benefit Utah's ratepayers. This is rate-making, not regulation of production, price or profit.

Mountain Fuel's contention that the roll-in of oil properties and profits violates the commerce clause because oil is developed and sold outside Utah is again contrary to the doctrine of this Court. This Court has squarely held that the commerce clause does not prohibit a state, in establishing utility rates, from classifying as utility properties for rate-making purposes properties located in other states. In *Lone Star Gas Co. v. Texas, supra,* this Court upheld, without requiring segregation of out-of-state properties from the rate base or segregation of revenues and expenses associated with those properties, an order of the Texas Railroad Commission reducing natural gas rates charged by a Texas utility.

> This was not a case where the segregation of properties and business was essential in order to confine the exercise of state power to its own proper province [citation omitted]. Here, as we have seen, the Commission in its method of dealing with the property and business of appellant as an integrated operating system did not transcend the limits of the state's jurisdiction or apply an improper criterion in its determinations. *Lone Star Gas Co., supra,* at 241.

Cf. Capital Transit Co. v. Public Utilities Commission of D.C., 213 F.2d 176, 179-81. (D.C. Cir. 1953).

Not only is Mountain Fuel's argument wrong as a matter of this Court's doctrine, but it flies in the face of

regulatory reality. It is both necessary and common for public utilities throughout this country to utilize out-of-state properties to provide services to consumers in their state of service. For example, Pacific Gas & Electric Company, in serving energy to California consumers, explores and develops oil and gas properties in Alaska.[8] Mountain Fuel itself explores for and develops hydrocarbons in Wyoming and Colorado for the purpose of providing natural gas to ratepayers in Utah. Because out-of-state properties are necessary to provide utility services, state public utility commissions have to include these properties in rate base and calculate rates on the basis of revenues and expenses from them. Mountain Fuel's commerce clause argument would have the effect of handicapping utilities in developing adequate sources of power to serve their consumers, and would handicap utility commissions in exercising the regulatory powers they need to set rates. Therefore, not only is Mountain Fuel's argument contrary to this Court's doctrine, but it would have the effect of stripping public commissions of power they use as a matter of course on a day-to-day basis. Mountain Fuel's position that this common practice violates the commerce clause is constitutional nonsense.

(c) Mountain Fuel's final claim the decision below burdens interstate commerce is based on the totally false premise that the holding of the Utah Supreme Court will regulate as public utilities independent

---

[8] **See, e.g., Re Pacific Gas & Electric Co., 97 P.U.R.3d 321 (Cal. Pub. Serv. Comm'n. 1972), where the California Commission gave ratepayers the benefits in rates of profits on oil discovered by the utility in Alaska.**

parties jointly exploring with Mountain Fuel and will regulate interstate gas sales between independent parties and Mountain Fuel. These premises are categorically false and are a misstatement of the Utah Supreme Court's holding. The issues in this case solely concern Mountain Fuel and its wholly-owned subsidiary, Wexpro, and the court's decision makes no holding and has absolutely no ramifications with respect to independent parties.

3. *The Utah Supreme Court's decision does not raise any issue of preemption.*

Mountain Fuel's claim that the Utah Supreme Court decision regulates both oil and gas in conflict with federal statutes and policy is also nonsense. Mountain Fuel attacks both the court's decision prohibiting Wexpro to make a profit on its sales of gas to Mountain Fuel at ratepayer expense, and the holding benefiting ratepayers by rolling in oil profits on utility properties explored and developed at ratepayer risk. Neither of these holdings is remotely preempted by any federal statute, regulation or policy.

Mountain Fuel claims the Natural Gas Act preempts the Utah Supreme Court's holding preventing Mountain Fuel from passing on in rates any more than the cost of service on natural gas it obtains from Wexpro. In making this argument, Mountain Fuel misanalyzes the Utah Supreme Court's decision. The decision does not regulate wholesale prices, but prohibits profits on wholesale sales between Mountain Fuel and its wholly-owned subsidiary, Wexpro, from being

charged to ratepayers in the retail price of gas. This action is fully consistent with this Court's holdings on this very point. Contrary to Mountain Fuel's position, the Natural Gas Act left it to the states to do exactly what the court below mandated. Prior to the passage of the Natural Gas Act, this Court held consistently and squarely the states had constitutional power to regulate charges in retail rates for natural gas purchased from affiliates, regardless of whether or not the gas was purchased from the affiliate in an interstate transaction. *Western Distributing Co., supra; Dayton Power & Light Co., supra; Lone Star Gas Co., supra.* The Natural Gas Act had no effect on that authority. *Panhandle Eastern Pipeline Co. v. Michigan Public Service Commission*, 341 U.S. 329 (1951); *Panhandle Eastern Pipeline Co. v. Public Service Commission of Indiana*, 332 U.S. 507 (1947). The Natural Gas Act "had no purpose or effect to cut down state power." *Panhandle v. Indiana, supra,* at 517. The Natural Gas Act was not intended and could not have been intended by Congress to render states helpless to protect consumers against affiliated companies' price manipulations, when the Court prior to the Act had held the states had clear power to provide consumers such protection. This Court stated in *Panhandle v. Indiana, supra*, with respect to the Act:

> [P]erhaps its primary purpose was to aid in making state regulation effective, by adding the weight of federal regulation to supplement and reinforce it in the gap created by the prior decisions. The Act was drawn with meticulous re-

gard for the continued exercise of state power, not to handicap or dilute it in any way.

* * * *

It would be an exceedingly incongruous result if a statute so motivated, designed and shaped to bring about more effective regulation, and particularly more effective state regulation, were construed in the teeth of those objects, and the import of its wording as well, to cut down regulatory power and to do so in a manner making the states less capable of regulation than before the statute's adoption. *Id.* at 517-19.

Therefore, Mountain Fuel's argument that Utah is constitutionally required to allow its natural gas public utility's stockholders to make a profit at ratepayer expense on gas "purchased" from its wholly-owned subsidiary is simply wrong.

Mountain Fuel argues that the entire decision of the Utah Supreme Court is preempted by "federal regulation [which] has been extended to completely eclipse state regulation in this field." (Petition at 25.) Mountain Fuel cites a string of federal statutes, including the Natural Gas Act, in support of this fatuous proposition (Petition at 24, n. 11). But federal statutes have not eclipsed the field and "ousted" state regulation. The very statutes cited by Mountain Fuel belie that proposition. Congress has expressly recognized in these statutes the traditional powers of the states over oil and gas matters. The absurdity of Mountain Fuel's position is seen, for example, in the Public Utility Regulatory Policy Act of 1978, 15 U.S.C. §§ 3201, *et seq.* (1978). That statute expressly provides:

Nothing in this chapter prohibits any State regulatory authority or nonregulated gas utility from adopting, pursuant to State law, any standard or rule affecting gas utilities which is different from any standard established by this chapter. 15 U.S.C. §3208.[9]

There is no pattern of Congressional law "eclipsing the field." In fact, Congress has demonstrated its intent not to do so. Nor is there any conflict between any federal policy, statute or regulation and the holdings of the Utah Supreme Court. The Utah Supreme Court does not in any way regulate production, price or profit of oil or gas. It rather articulated and implemented uniformly accepted principles of ratemaking. Allocation of profits according to the principle gain follows risk is not regulation of production, price or profit. Mountain Fuel necessarily misstates the holdings because it realizes an accurate reading of the decision raises no federal issue of any sort.

Once again, Mountain Fuel's position flies in the face of regulatory reality. Mountain Fuel would have this Court eliminate all classes of state regulation over any aspect of the oil and gas business. It would eliminate state regulation preventing waste of oil and gas. It would eliminate state regulation promoting conservation. It would eliminate state boards with the juris-

---

[9] **See also** the Federal Energy Petroleum Allocation Act, cited by Mountain Fuel, which again demonstrates Congress' recognition that federal regulation has not "completely eclipsed" the field. This Act, by its express terms, preempts only state regulation over allocation of refined petroleum products which are in actual conflict with regulations promulgated pursuant to it. 15 U.S.C. §755(b).

diction and authority necessary to promote conservation. It would eliminate state laws requiring well permits and the spacing of wells.[10] The argument is simply untenable.

Mountain Fuel states that the Utah Supreme Court's decision frustrates federal policy by "siezing profits" on Wexpro's oil sales because Mountain Fuel's "exploration and development program will be compelled to phase out and end." (Petition at 26.) This is nothing more than a thinly-veiled temper tantrum by Mountain Fuel's stockholders who threaten to end their exploration program if they do not get their own way. But a temper tantrum does not produce a federal constitutional issue. Mountain Fuel's contention the decision eliminates price incentives in violation of federal policy is wholly inaccurate. Price incentives are not eliminated by the decision. Mountain Fuel has always been free, and still is free, to engage in a free-enterprise oil and gas exploration program of its own. Mountain Fuel has the same price incentives as any other company. All it needs to do is put its stockholders' money at risk, rather than use the profits generated by its utility program to foster the enterprise. Nor is the threat to end the program credible, because this temper tantrum cannot limit Mountain Fuel's obligations under Utah law to serve as a public utility under Utah's regulatory authority.

---

[10] **See, e.g., §§ 40-6-1, et seq., U.C.A. (1953).**

Finally, the claim that this decision will invite other states to "sieze profits" from utilities rings hollow. The Utah Supreme Court was faced with a wholly-unique problem. No other utility in this country ever developed this unique system of classification to give its shareholders the best of both worlds in its exploration and development of oil and gas at the expense of ratepayers. Mountain Fuel's conduct was unique and the decision will not have the ramifications claimed by Mountain Fuel. Mountain Fuel's claim that this abuse of Utah consumers rises to the level of constitutional principle warrants no consideration by this Court.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

DATED this 28th day of November, 1979.

Respectfully submitted,

ROBERT B. HANSEN
Attorney General of the State of Utah
State Capitol Building
Salt Lake City, Utah 84114

DANIEL L. BERMAN
JAY D. GURMANKIN
Special Assistant Attorneys General
500 Kearns Building
Salt Lake City, Utah 84101

JAMES L. BARKER
Assistant Attorney General of
the State of Utah
State Capitol Building
Salt Lake City, Utah 84114

Counsel for Utah Committee of Consumer Services

STEPHEN R. RANDLE
Assistant Attorney General
of the State of Utah
State Capitol Building
Salt Lake City, Utah 84114

Counsel for Utah Department of Business Regulation, Division of Public Utilities

IN THE SUPREME COURT OF THE UNITED STATES

MOUNTAIN FUEL SUPPLY COMPANY, WEXPRO COMPANY, and ALEX OBLAD, HAROLD BURTON, and CARLYLE HARMON,	:	ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF UTAH
Petitioners,	:	October Term, 1979
v.	:	No. 79-604
UTAH COMMITTEE OF CONSUMER SERVICES and UTAH DEPARTMENT OF BUSINESS REGULATION, DIVISION OF PUBLIC UTILITIES,	:	CERTIFICATE OF SERVICE OF RESPONDENTS' BRIEF IN OPPOSITION
Respondents.	:	

The undersigned attorney, who is a member of the bar of this Court, hereby certifies, pursuant to Rule 33 of the Rules of the Supreme Court of the United States, that on this 27th day of November, 1979, copies of the attached Brief in Opposition to Petition for Writ of Certiorari were duly served on the Petitioner by depositing three (3) copies thereof in the United States mail, with postage prepaid, addressed to counsel of record at their addresses listed below:

Calvin L. Rampton, Esq.
800 Walker Bank Building
Salt Lake City, Utah 84111

Edward W. Clyde, Esq.
351 South State Street
Salt Lake City, Utah 84111

Robert S. Campbell, Jr., Esq.
310 South Main Street, 12th Floor
Salt Lake City, Utah 84101

Milly O. Bernard, Chairman
Public Service Commission
330 East Fourth South
Salt Lake City, Utah 84111

Olof E. Zundel, Commissioner
Public Service Commission
330 East Fourth South
Salt Lake City, Utah 84111

Kenneth E. Rigtrup, Commissioner
Public Service Commission
330 East Fourth South
Salt Lake City, Utah 84111

Utah Public Service Commission
330 East Fourth South
Salt Lake City, Utah 84111

Daniel L. Berman
BERMAN & GIAUQUE
500 Kearns Building
Salt Lake City, Utah 84101

Special Assistant Attorney
General of the State of Utah

SUPREME COURT, U.S.
FILED
DEC 4 1979
MICHAEL RODAK JR. CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
SUPREME COURT OF THE STATE OF UTAH

REPLY BRIEF OF PETITIONERS

ROBERT H. BORK
142 Huntington Street
New Haven, Connecticut 06511

CALVIN L. RAMPTON
800 Walker Bank Building
Salt Lake City, Utah 84111
Counsel for Wexpro Company

ROBERT S. CAMPBELL, JR.
310 South Main Street,
12th Floor
Salt Lake City, Utah 84101

REX E. LEE
2840 Iroquois Drive
Provo, Utah 84601
Counsel for Mountain Fuel Supply Company

EDWARD W. CLYDE
351 South State Street
Salt Lake City, Utah 84111
Counsel for Stockholders

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

REPLY BRIEF OF PETITIONERS

Respondents' brief removes any possible doubt that Utah has violated fundamental constitutional rights that should be vindicated by this Court through the grant of certiorari.

Respondents rely entirely upon one flat factual misrepresentation. Respondents thus implicitly concede (as they must, under the precedent of this Court) that, if the

fact is as petitioners have stated it, Utah has imposed an undue burden upon interstate commerce, impermissibly interfered with federal energy regulatory law, and taken petitioners' property without just compensation.[1]

The factual misrepresentation is respondents' assertion that Mountain Fuel's gas ratepayers took the risk of Mountain Fuel's exploration for oil so that the oil properties "are and always have been" utility assets. If that were true, then Utah's decision to appropriate all oil profits above a utility rate of return would, at least arguably, not violate petitioners' constitutional rights.

But the factual assertion of respondents is obviously false, and Utah may not disguise its interference with commerce and federal regulation as well as its taking of property by simply announcing that any properties it chooses to appropriate are instantaneously "utility" assets. That semantic maneuver, if permitted to succeed, would leave both federal regulatory power and private property rights empty constitutional shells.

1. *Respondents' Factual Misrepresentation: Ratepayer Risk.* The record on this matter is clear and unambiguous. The gas utility customers of Mountain Fuel never paid for Mountain Fuel's oil exploration and development program and never took any risk with respect to that program. The

---

[1] While normally this Court does not sit to decide factual questions, that rule gives way when the fact is both easily ascertained and its determination essential to the preservation of basic constitutional rights. Indeed, constitutional rights and this Court's reviewing function are rendered meaningless if a respondent can defeat certiorari by misstating a single crucial fact.

claim of beneficial ownership in revenues from the oil properties is, therefore, utterly groundless.

The facts are:

(a) The Utah Commission made it plain throughout the life of Mountain Fuel's exploration and development program that an exploration expense would be recognized in the gas rates only so long as the program brought to the utility ratepayers gas at a cost-of-service price below the price of comparable field or pipeline supplies. Ratepayers bore no risk because the utility operations would recover no exploration expense if the program were not successful.[2]

(b) The notion that a ratepayer, in purchasing natural gas from Mountain Fuel, took a "risk" or

---

[2] Respondents' characterization of this statement as "wholly false" (Resp. Br. 12) is quite remarkable. In addition to the categorical statements by the Utilities Commission in *Utah P.S.C. Case No. 4797* (1960) (R.5639) and *Utah P.S.C. Case No. 5907* (1968) (R.5663) that "a vigorous exploration and development program should be continued so long as the cost incurred in developing new supplies of gas are lower than the average cost of purchased gas," the Utah Commission stated in the 1978 *Case No. 76-057-14*:

> The risks of success of the exploration and development program are burdens which, in the first and last analyses, we place on the Company and its shareholders. If the program is unsuccessful or unproductive and does not yield new low cost natural gas reserves, it is not the utility customers that must account for such, but rather it is the Company, its management and its owners who must shoulder responsibility . . . . (See App. B29 to our Petition)

Even more remarkable is the claim of respondents that petitioners have raised the Utilities Commission's long-announced policy on "ratepayer risk" for the first time in this Court. (Resp. Br. 12) In addition to extended presentation before the Utah Commission, the matter was placed directly before the Utah Supreme Court by Mountain Fuel in its main brief, pages 73-74, under the title "The Gas Customers Have Never Assumed the Risk of the Company's Exploration and Development Program."

made an investment in the exploration and development program of the Company, is absolutely devoid of any evidentiary support in the record and contradicts fundamental precepts of the American economy. "Ratepayer risk" is nothing more than a slogan invented by respondents before the Commission below.

(c) Shareholders, not ratepayers, paid all of the capital costs of oil and gas exploration and development. These costs are not and have never been reimbursed in the rates, and capital losses have always been borne entirely by the shareholders.

(d) Respondents allege that Mountain Fuel's oil and gas exploration has always been carried on as a public utility function. (Resp. Br. 5-6) It clearly has not. A vigorously competitive, high risk business venture, Mountain Fuel's program was only a utility function to the extent that the Utilities Commission made it one by its allowance of an exploration expense in utility rates and its inclusion of gas producing properties in rate base.

Exploration expense for oil property was never reflected in the rates and the oil business was consistently treated as and ordered to be an independent, unregulated function of Mountain Fuel.

Expenses of joint exploration are shared by the non-utility (Wexpro) and utility divisions because the program produces both oil and gas. It is uncontroverted that prior to 1972 the non-utility oil division paid a slightly larger proportion of the exploration expense than the proportion of revenues it received from the program. Correspondingly, the utility gas division paid a proportion of exploration expense slightly smaller than its share of total oil and gas

revenues.[3] Since 1972, the Utilities Commission has adjusted the share of expenses that may be paid by Mountain Fuel's utility division, and hence reflected in gas rates, according to the continuing experience of the Company in the proportions of gas and oil found. The Utilities Commission currently will not permit the utility division to pay more than 50 percent of expenses, although in recent years more gas than oil has been found, so that the non-utility oil business has been subsidizing the utility gas business.[4]

From its earliest examination of rate base in 1940, the Utilities Commisison has *strictly and consistently required* Mountain Fuel to keep its oil properties and investment out of rate base.[5]

It is manifest that the Utilities Commission regarded Mountain Fuel's exploration program as a utility function only to the extent of gas discoveries

---

[3] Petitioners are at a loss to account for respondents' reckless assertion that Mountain Fuel ratepayers paid for "all unsuccessful exploration—every single dry hole." (Resp. Br. 9) Not only did the ratepayers not pay for all unsuccessful exploration, the utility division paid even less than its proportionate share. Exhibit MFS-8 (R. 3688), relied upon also by respondents, manifests that from 1960-1976, the shareholders paid $11.8 million more than the Commission authorized for utility exploration expense, alone, not to mention all of the exploration expense of the non-utility division. Even respondents' Exhibit DIV-1 (R. 3675) reflects that between 1966-1972, the non-utility oil division paid 3.4% of joint dry hole exploration at a time that oil revenues were 3.7%. (As pointed out earlier, for the larger 11-year period 1960-1970, the non-utility proportion of joint dry hole expense was 3.2% while proportionate oil revenues were 3.1%.) (R. 3792[8], 3800[24], 5723) For the four-year period 1973-1976, the oil operations bore 46% of joint dry hole expense.

[4] Since Wexpro was created in January 1977, it has paid one-half of all joint exploration expenses. Yet in the last two years, the joint program of the two companies has discovered 55 gas wells and no oil wells. (See 1977 and 1978 Annual Reports of Mountain Fuel Supply Company)

[5] *Re: Mountain Fuel Supply Co.*, 33 P.U.R. (N.S.) 3, 13-14 (1940); *Utah P.S.C. Case No. 4392* (1957) (R. 5615-16); *Utah P.S.C. Case No. 5907* (1968) (R. 5706-07)

and expectations of gas discoveries based on recent historical performance. Thus, even under the illusory "ratepayer risk" theory of respondents, the risk could only have been with respect to gas and not oil.

It therefore follows ineluctably that the ratepayers were completely insulated from any risk associated with exploration for oil. If, as respondents insist, "gain follows risk," Mountain Fuel's shareholders have always been, and are now, entitled to the full unregulated revenues from the non-utility oil properties.

That same conclusion is compelled, as we have shown in our petition, by the specific Utah statute, Utah Code Ann. § 54-2-1(30) (1974), by the consistent practical construction of that statute by Utah for forty years, and by repeated, final orders of the Utilities Commission classifying the very oil properties in question as non-utility assets.

2. *Interference with Interstate Commerce.* Respondents claim that we are wrong to read the Utah court's opinion as regulating the price at which Wexpro may sell gas from independently developed acreage to Mountain Fuel. (Resp. Br. 23) That our statement is accurate is shown by the following language of the Utah opinion itself: "Under the amended purchase and sale agreement, there is a provision for Mountain Fuel to purchase, at *market price* rather than cost-of-service, the gas discovered on properties acquired by Wexpro, *other than transferred acreage and that which comes to it under the joint exploration agreement.* This provision *violates* the 'no-profits-to-affiliates' rule." (See App. A5-6) (Emphasis added) It is palpably clear, therefore, that Utah intends to regulate directly the price of gas sold in interstate commerce.

Respondents' denial that Utah will regulate the profits on interstate sales of oil is incomprehensible. Respondents

state, "[A]ll the Utah Supreme Court held with regard to Mountain Fuel's oil profits is that net profits beyond all costs associated with production, including the cost of capital, from oil developed as a utility activity at the sole risk of ratepayers, should benefit Utah's ratepayers. This is rate-making, not regulation of production, price or profit." (Resp. Br. 26-27)

The fallacy of this contention has already been demonstrated. Respondents contend that all oil was developed at the sole risk of the ratepayers, whereas, as shown above, no oil was. The Utah Supreme Court's holding that all profits above a low utility rate of return should be taken from Wexpro and given to Mountain Fuel's gas ratepayers, therefore, is precisely a regulation of the profits on interstate sales of oil resulting in a burden on commerce so intolerable that the commerce will be required to terminate.

3. *State Interference with Federal Regulation of Oil and Gas.* Respondents attempt to avoid the force of petitioners' preemption argument by overstating it. Petitioners' argument is not that the states are without authority to regulate some administrative aspects of oil and gas production such as well-head spacing, but that states may not regulate the prices or rates of return on oil or gas sales in or affecting interstate commerce, because those subjects are completely preempted by federal law. Respondents, understandably, would rather talk about something else. Thus, they cite an obscure section of the federal Public Utility Regulatory Policy Act of 1978, which leaves the states free to regulate utility advertising and termination of service to customers for non-payment of bills.[6] (Resp. Br. 30-31) This provision has nothing to do with state regulation of natural gas prices and oil profits.

---

[6] *See,* 15 U.S.C. §§ 3201-3211 (Supp. 1979)

The demonstration in our petition that prices and profits on oil and gas sales in interstate commerce are now exclusively matters of federal regulation is, we continue to submit, unassailable.

4. *The Taking of Petitioners' Property.* Respondents contend that petitioners have lost nothing under the Utah Supreme Court holding because they still have retained their capital investment in the non-utility oil properties. (Resp. Br. 20-21) The appropriation of petitioners' oil profits, however, slashes the value of that oil investment. One who is left with title to property, after being stripped of most of its value, has suffered an unconstitutional "taking" in the only meaningful sense of that term. *U.S.* v. *Causby,* 328 U.S. 256 (1946).

It is disingenuous to argue, as respondents do (Resp. Br. 17), that the taking here is not retroactive because Utah will appropriate only future revenues. The appropriation of future revenues is the appropriation of most of the capital value of the property, and hence of investments made in prior years.

If words mean anything, the sudden reclassification in 1979 of petitioners' oil properties from a non-utility oil to a utility gas status, thus destroying legitimate, investment-backed expectations, is retroactive. In this case, Utah did not say future investments will be treated in this way. It said *past investments*, made in specific reliance upon established and well-understood rules, will now be treated in a newly invented way. That is retroactive.

5. *Other Accusations of Respondents.* The misstatements and demagogic characterizations in the respondents' opposition brief are several, but this is not the time to engage in a point by point retort.

One thing remains certain for certiorari consideration. This is not a once in a lifetime case. Investor-owned utilities throughout the United States have unregulated, non-utility businesses whose assets will lure "consumerists" as Mountain Fuel's investor-owned oil has lured respondents. If Utah's attempt succeeds, other state and local governments will inevitably expropriate private property rights in order to subsidize even lower consumer utility rates, resulting in the obstruction of interstate commerce and the frustration of uniform national energy policy.

CONCLUSION

A writ of certiorari should be granted to the Supreme Court of Utah to review its order of May 10, 1979.

Respectfully submitted,

ROBERT H. BORK
142 Huntington Street
New Haven, Connecticut 06511

ROBERT S. CAMPBELL, JR.
310 South Main, Suite 1200
Salt Lake City, Utah 84101

REX E. LEE
2840 Iroquois Drive
Provo, Utah 84601
Counsel for Mountain Fuel Supply Company

CALVIN L. RAMPTON
800 Walker Bank Building
Salt Lake City, Utah 84111
Counsel for Wexpro Company

EDWARD W. CLYDE
351 South State Street
Salt Lake City, Utah 84111
Counsel for Stockholders

Supreme Court, U. S.
FILED
NOV 29 1979
MICHAEL RODAK, JR., CLERK

In The

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, AND
ALEX OBLAD, HAROLD BURTON, AND
CARLYLE HARMON,
Petitioners,

versus

UTAH COMMITTEE OF CONSUMER SERVICES AND
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,
Respondents,

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE OF UTAH

Brief *Amicus Curiae* of the
Mountain States Legal Foundation
in Support of Petition for Certiorari

MOUNTAIN STATES LEGAL FOUNDATION
JAMES G. WATT
GALE A. NORTON
1845 SHERMAN STREET, SUITE 675
DENVER, COLORADO 80203
ATTORNEYS FOR AMICUS CURIAE

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF THE AMICUS . . . . . 1.

QUESTION PRESENTED . . . . . 2.

SUMMARY OF THE ARGUMENT . . . . . 2.

ARGUMENT . . . . . 2.

I. The Utah Supreme Court decision orders the confiscation of the shareholders' earnings (private property) derived from non-utility business activities 3.

II. The Utah court's decision would require government regulation of independent businesses, thus discouraging new development of needed energy . . . . . 6.

III. The Utah decision will destroy an active and successful exploration program, and if considered as precedent, could seriously reduce exploration activities throughout the nation . . . . . 8.

CONCLUSION . . . . . 10.

TABLE OF AUTHORITIES

CASES — Page

Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. 23 (1926). . . . . 5.

Cleary v. Chalk, 488 F.2d 1315, (D.C. Cir.), *cert. denied*, 416 U.S. 938 (1973). . . . . 5.

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944). . . . . 3.

Northern Pacific Ry. v. North Dakota ex rel. McCue, 236 U.S. 585 (1915). . . . . 3.

Smyth v. Adams, 169 U.S. 466 (1898). . . . . 9.

OTHER AUTHORITIES

1 A. PRIEST, PRINCIPLES OF PUBLIC UTILITIES REGULATION 3-5 (1969). . . . . 3.

Dibee, *The Functions of Profits in Industry in General and in Regulated Public Service Industries in Particular*, in NEW CONCEPTS AND CURRENT ISSUES IN PUBLIC UTILITY REGULATION 159 (B. KOLB AND O. LIPSTEIN, eds. 1963). . . . . 8.

Gifford, *Functions of Profits in Public Service Industries*, in NEW CONCEPTS AND CURRENT ISSUES IN PUBLIC UTILITY REGULATION 166 (B. KOLB AND O. LIPSTEIN, eds. 1963). . 8.

In The

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, AND
ALEX OBLAD, HAROLD BURTON, AND
CARLYLE HARMON,
Petitioners,

versus

UTAH COMMITTEE OF CONSUMER SERVICES AND
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,
Respondents,

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE OF UTAH

INTEREST OF THE AMICUS

The Mountain States Legal Foundation is a public interest legal center dedicated to bringing before the courts those issues vital to the protection and defense of individual liberty, freedom of economic expression, and traditional legal institutions in the United States. The Foundation, as a public interest law group which is not a party to these proceedings, is in a unique position to present a studied reflection on the impact of legal developments upon the nation.

The Foundation files this brief urging the United States Supreme Court to review the decision of the Utah Supreme Court, because the latter court has adopted a position which is an extreme departure from constitutional and statutory principles of law. If allowed to stand, the decision will significantly alter American and Utah jurisprudence, will dramatically and adversely impact the development of energy resources in Utah and the West, and will severely damage the

interests of utility ratepayers, shareholders, the general public and the private enterprise system. Furthermore, the Utah court decision seeks to impose a new order of economic rights which allows the confiscation of a portion of shareholders' earnings.

Mountain States Legal Foundation has received written consent from all parties to file this brief as *amicus curiae*. Copies of these letters have been filed with the Clerk of the Court.

QUESTION PRESENTED

Does the Utah Supreme Court's decision undermine federal and state economic, regulatory, and energy policies, violate private property rights, and damage the American private enterprise system to such a degree that review of this Court is imperative?

SUMMARY OF THE ARGUMENT

Through a decision which violates provisions of the Constitution and of federal and state statutes, the Utah Supreme Court has formulated a theory that will disrupt the economic, regulatory and energy policies established by the Congress, the legislatures, and the courts. The decision will erode the concept of private property rights by allowing shareholders' earnings from a non-utility business to be confiscated without due process. It will impair exploration for petroleum resources by obstructing joint venture efforts between public utilities and independent oil companies. The decision sacrifices the long-term interests of energy consumers by destroying an active and successful petroleum exploration program. If allowed to stand, the decision will establish precedent that will significantly reduce oil and gas production throughout the West.

The severe and possibly unanticipated consequences of the Utah decision create an urgent need for review by the Supreme Court of the United States.

ARGUMENT

The decision of the Utah Supreme Court is seriously flawed from a legal standpoint because it totally disregards important statutory and constitutional provisions. The court's decision imposes state regulation in an area of federal preemption, takes private property without due process and just compensation, and burdens interstate commerce. Because the Utah Supreme Court's decision was a significant departure from established legal principles, the Foundation presented to the Utah court a brief in support of Mountain Fuel Supply

Company and Wexpro Company's petition for rehearing. The brief covered the law on four points: improper judicial fact-finding, the court's misunderstanding of regulatory concepts, the extra-territorial expansion of Utah jurisdiction over natural gas production in Wyoming and other Western states, and federal preemption of the regulation of crude oil sales. The Utah Supreme Court ignored these issues, which have now been presented to this Court in the Petition for a Writ of Certiorari.

This *amicus* brief will not reiterate the legal challenges to the Utah Supreme Court decision. Instead, this brief will discuss the drastic social and economic ramifications of the decision that urgently demand United States Supreme Court review.

I.
THE UTAH SUPREME COURT DECISION ORDERS THE CONFISCATION OF THE SHAREHOLDERS' EARNINGS (PRIVATE PROPERTY) DERIVED FROM NON-UTILITY BUSINESS ACTIVITIES.

For many years the courts have struggled to define the nature of public utility businesses. In order to protect the public from exploitation by natural monopolists, both federal and state governments established regulatory mechanisms for simulating the controlling effects of the competitive marketplace. The primary duty imposed upon those businesses designated as public utilities was to provide adequate service at a reasonable price. 1 A. Priest, Principles of Public Utilities Regulation 3-5 (1969). *See also Northern Pacific Ry. v. North Dakota ex rel. McCue,* 236 U.S. 585 (1915); *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591 (1944).

The decision of the Utah Supreme Court goes far beyond these historically accepted guidelines and imposes a requirement that is inconsistent with the principles of a capitalist economy. An investor-owned utility company should retain its essential character as a private enterprise despite its utility transactions. When it has fulfilled its duty to provide adequate service at a reasonable price, it has met its responsibility to the public.

There are definite limits upon the duties of a public utility company, and state regulation cannot demand public services beyond those bounds. In the *Northern Pacific* case, this Court held that

> the public interest cannot be involved as a

> justification for demands which pass the limits of reasonable protection, and seek to impose upon the carrier [i.e., the public utility] and its property burdens that are not incident to its engagement. 236 U.S. at 595.

Thus a public utility cannot be required to dedicate a non-utility business to the public good without due process and just compensation. The Utah decision would illegally require Mountain Fuel to devote its oil business to the public use, in violation of the shareholders' constitutional rights.

The *Northern Pacific* decision makes clear that the Utah Supreme Court's holding would extend the Public Service Commission jurisdiction beyond its constitutional limits.

> The constitutional guaranty protects the carrier [public utility] from arbitrary action and from the appropriation of its property to public purposes outside the undertaking assumed. 236 U.S. at 604.

Under the Utah decision, the state would regulate not only those shareholder properties devoted to public service as "public utilities," but regulation would also be expanded to include those properties intended to be handled as separate, private businesses.

There is a subtle but crucial distinction between requiring a utility to provide its utility services at a reasonable rate that approximates a competitive market price and, on the other hand, forcing a utility to subsidize its utility rates by using earnings derived from non-utility activities. The utility should provide services at cost plus a reasonable profit; it should not be forced to provide services at less than cost whenever an unregulated subsidiary enters into a profitable venture.

The new Utah brand of public utility law provides that a customer who purchases goods acquires an ownership right, (i.e., the right to share in the earnings) in the company that produces those goods. When stripped of its public utility and petroleum exploration jargon, the Utah Supreme Court holding becomes patently confiscatory.

A simple example will serve to illustrate the inconsistency of the Utah Supreme Court decision with the traditions of a free-enterprise economy. The provision of natural gas to consumers can easily be analogized to the sale of a manufactured product. Whenever a consumer purchases an item in a store, a portion of the price of that item will include the costs of research and development for new products, marketing

research to open new stores, and advertising to attract new customers. Obviously, however, the consumer does not become automatically entitled to a share of the profits from the new products or new markets merely because a part of his purchase price covered those business expansions. Likewise, the consumer of natural gas services does not acquire an ownership interest in the utility by paying a portion of the cost-of-service price for exploration. However, the situation presented to the Court here is even more clearcut — earnings involved are those of a *non-utility* business conducted by the privately owned utility.

The position of the Utah Supreme Court is directly contrary to that adopted by this Court in *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926). This Court recognized that a privately owned utility is not a trustee for its customers; rather, it operates under the same basic principles as any other business. "The revenue paid by the customers for service belongs to the company." 271 U.S. at 31. Furthermore, this Court emphasized that customers are not owners entitled to share in earnings: "By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company." 271 U.S. at 32.

One final point raised by the *New York Telephone* decision should be emphasized at this time. The decision dealt specifically with the use of an amount in a reserve depreciation account to offset current expenses and thereby to lower rates below those which could be otherwise sustained. The Court held: "Profits of the past cannot be used to sustain confiscatory rates for the future." 271 U.S. at 32. The Mountain Fuel/Wexpro situation is essentially similar. The only difference is that, rather than applying past accumulations of financial reserves to offset current expenses, the Utah court is attempting to apply a corporate subsidiary's non-utility earnings to offset utility expenses. Profits from non-utility activities cannot be used to sustain confiscatory rates for utility services. *See Cleary v. Chalk*, 488 F.2d 1315, 1324 (D.C. Cir.), *cert. denied*, 416 U.S. 938 (1973), which held that "[i]t is well settled that income received by a public utility from nonoperating property is not to be considered in establishing the rate. . . ."

The Utah Public Service Commission is charged, as regards Mountain Fuel, with regulating natural gas rates. It is not statutorily entitled to regulate oil developers. Yet the state court's decision would vest this power in the Commission. The

reasonable cost of providing gas does not vary with the rise or fall of oil prices; the oil business is separate. To consider its losses in determining the cost of providing natural gas would be unfair to consumers; to consider its gains would be to confiscate the non-utility property of the shareholders. The Mountain Fuel oil business has never been considered a utility business. Even if the Utah Public Service Commission attempted to regulate the oil operations directly, it would be prohibited from doing so through preemption by the federal government. (The preemption issue is more fully discussed in the Petition for a Writ of Certiorari.)

Utility regulators may be justified in ignoring the legal fiction of a separate corporation when a utility company purchases goods or services from an affiliate at a higher price than it would pay on the open market, the affiliate thus being used as a means of gaining hidden profits. No such allegation is made here. The conditions of any sales of natural gas by Wexpro to Mountain Fuel were explicitly spelled out by the original Utah Public Service Commission decision, and the legitimacy of such regulatory action is not challenged.

In the broader context, this case must be seen as an erosion of the concept of private property rights. The Utah Supreme Court has asserted that the shareholders of a corporation cannot devote a portion of that organization's assets to the public service unless they are willing to so devote the entirety of corporate and subsidiary property. This assertion would discourage corporations, particularly those engaged in other profitable business ventures, from entering the public utility area. The state court has also asserted that the judiciary can act, without seeking legislative direction, to declare that private property has been transformed into public utility property. And finally, the Utah court has ignored prior United States Supreme Court decisions limiting the extent of regulation of utility companies. This unprecedented dilution of private property rights will undoubtedly have a destructive impact upon the American free enterprise system.

II.
THE UTAH COURT'S DECISION WOULD REQUIRE GOVERNMENT REGULATION OF INDEPENDENT BUSINESSES, THUS DISCOURAGING NEW DEVELOPMENT OF NEEDED ENERGY.

The Utah Supreme Court's statement of the Wexpro actions that render it a public utility is so broad that it will encompass

the actions of any independent gas producer that enters into a joint agreement with Mountain Fuel. The court has ruled:

> Wexpro, by its joint activities with Mountain Fuel, particularly upon the transferred properties is both performing a service, viz., facilitating the production of natural gas, and delivering natural gas to its parent, both of which constitute Wexpro a public utility. Petition for a Writ of Certiorari at A13.

This ruling creates the possibility of unwarranted expansion of Utah Public Service Commission jurisdiction. Consequently, it is likely that Mountain Fuel will be unable to secure new sources of natural gas from independent natural gas operators. Few, if any, Utah gas well owners would want to subject themselves to regulation by the Utah Public Service Commission. Operators in states other than Utah would also be threatened by this ruling merely because they have furnished natural gas to Mountain Fuel. This raises the spectre that an independent producer would be subject to regulation by any state in which one of its customers was regulated. Clearly, this would lead to conflicting regulations and is precisely why federal regulation has preempted the oil and gas area. Not only would this regulatory complication seriously diminish Mountain Fuel's ability to attract joint venturers, but it would impose a threat of taking without due process upon any independent producer that did enter into such an agreement.

The joint venture concept is extremely important to the entire petroleum industry. In order to spread the risks of exploration, producers often share expenses and responsibilities for exploration of a given tract of land. The joint venture practice makes entry by small producers more feasible, since it allows them to diversify the risks involved in encountering a dry hole. A small company with all of its capital concentrated on one project would be easily ruined by an unsuccessful drilling project, while one that had its capital spread among several joint venture projects would be considerably more stable. Inhibitions of joint exploration agreements would thus have a seriously detrimental effect upon the competitive structure of the oil and gas production industry by forcing small independent producers out of the market. Potentially even more serious is the interference with oil and gas exploration. Today, there are over 12,000 independent petroleum producers. This group is responsible for 90% of all wildcat wells and 80% of all drilling in the continental United States. The vast majority of these activities are undertaken as

joint ventures.

The serious and far-reaching consequences of discouraging joint venture agreements should not be instituted without study and contemplation. This Court should grant certiorari to halt the possibly unforeseen and unintended results of the Utah decision.

III.
THE UTAH DECISION WILL DESTROY AN ACTIVE AND SUCCESSFUL EXPLORATION PROGRAM, AND IF CONSIDERED AS PRECEDENT, COULD SERIOUSLY REDUCE EXPLORATION ACTIVITIES THROUGHOUT THE NATION.

A vigorous exploration program is necessary for the success of any fossil fuel producer. On a national scale, exploration is necessary to alleviate petroleum shortages and maintain the health of the national economy. Exploration becomes more difficult and costly over time as easily accessible reserves are depleted.

The overriding necessity for exploration, under the Utah Supreme Court decision, is sacrificed to the political expediency of reducing immediate costs to ratepayers. The determination of whether the public interest is more readily served by short-term price reduction or by long-term increase in fuel production should involve fact-finding with adequate information, deliberation, and expertise. The Utah Public Service Commission, a body that devoted considerable time and expertise to this process, placed its emphasis on balancing the legal rights of all parties and upon future development of adequate supplies of natural gas.

It is a guiding principle of the American free enterprise system that production is encouraged by profit incentives. The American public service industry is over 80% owned by private interests. Dibee, *The Functions of Profits in Industry in General and in Regulated Public Service Industries in Particular,* in NEW CONCEPTS AND CURRENT ISSUES IN PUBLIC UTILITY REGULATION 159, 162 (B. KOLB AND O. LIPSTREN, eds., 1963). Functions of profits include attracting necessary capital, making growth possible, providing management incentive, and facilitating research and development of exploration activities. Gifford, *Functions of Profits in Public Service Industries,* in B. KOLB AND O. LIPSTREN, *supra,* 166, 167.

These factors, combined with other basic realities of business, illustrate why it is almost universally recognized that earnings provide incentive for public utilities as well as for private industry. The importance of a reasonable rate of return on investment is emphasized throughout public utility law, from the early case of *Smyth v. Adams,* 169 U.S. 466 (1898), to current public utilities cases.

The central concept of the investor-owned utility must be remembered — that of a privately owned business whose property has been dedicated to the public use. Investors are to be reasonably compensated for this use of their assets. This case does not, however, involve an ordinary determination of rate of return. It involves the extent to which a non-utility operation may be pressed into service as a public utility without due process, such that its probable earnings will be reduced significantly and utilized to subsidize other traditional public utility functions.

In this time of energy crisis and shortage of fuels, it is not wise to diminish earnings of small producers and thereby inhibit exploration for and production of new energy supplies. Despite the current image of high oil industry profits, competitors in the industry are not assured instant success. This is an industry where high costs for exploration must be incurred, and where unsuccessful drilling projects are many times more common than successful ones. The effect of the Utah Supreme Court decision will be to cause the Wexpro/Mountain Fuel shareholders to operate an oil production business at a rate of return significantly below that of the rest of the industry. This is in direct conflict with accepted public utilities law requiring returns "commensurate with returns on investments in other enterprises having corresponding risks." *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944).

However, the Utah decision is particularly egregious because it will significantly expand the scope of state regulation by indirect means, without ever making the determination that the oil industry is a public utility industry under Utah law. (The Utah court's authority to make such a legislative decision that would operate in an area of federal preemption is certainly not conceded.)

In addition, the unconstitutional Utah Supreme Court decision would remove from management discretion one tool that has been used by public utility management to attract capital and assure availability of funds for corporate growth without raising the costs to utility customers, i.e., prudent investment in non-utility activities. The higher return possible on these

investments makes equity capital more readily available, but because it is conducted separately from the utility business, the utility ratepayer bears no burden of risk or involvement.

The net effect of the Utah decision, if allowed to stand as precedent, will be to discourage the entry of natural gas producers into oil exploration and to diminish the exploratory activities of existing oil and gas producers. This short-sighted holding will inevitably cause decrease availability of fossil fuels, will raise utility rates, and will work to the detriment of the consumers in the State of Utah.

CONCLUSION

The foregoing discussion highlights the reasons that Mountain States Legal Foundation believes United States Supreme Court review to be imperative.

It is clear that the Utah decision is invalid, based upon the legal reasons outlined in the Petition for Certiorari. The legal infirmities of the Utah decision indicate a need for Supreme Court review.

The widespread economic chaos that will result from this decision makes Supreme Court intervention imperative.

Respectfully submitted,

JAMES G. WATT
GALE A. NORTON
1845 SHERMAN STREET, SUITE 675
DENVER, COLORADO 80203
ATTORNEYS FOR AMICUS CURIAE
MOUNTAIN STATES LEGAL FOUNDATION